Challenger Limited
Analyst Pack

1H15
31 December 2014

challenger

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Important Note

Information presented in the 1H15 Analyst Pack is presented on an operational basis (rather than statutory) to reflect a management view of the business. Challenger also provides statutory reporting as prescribed under the Corporations Act 2001. The 31 December 2014 interim financial report is available from Challenger's website at **www.challenger.com.au**.

The 1H15 Analyst Pack is not audited. The statutory net profit after tax as disclosed in the consolidated profit and loss (see page 2) has been prepared in accordance with Australian Accounting Standards and the Corporations Act 2001. Challenger's external auditors, Ernst & Young, have reviewed the statutory net profit after tax as disclosed in the consolidated profit and loss. Normalised net profit after tax, as disclosed in the consolidated profit and loss (see page 2) has been prepared in accordance with a normalised profit framework (see page 33). The normalised profit framework has been disclosed in the Directors' Report and Note 2 – segment information, in the Challenger Limited 31 December 2014 interim financial report. The normalised profit after tax has been subject to a review performed by Ernst & Young.

Any forward looking statements included in this document are by nature subject to significant uncertainties, risks and contingencies, many of which are outside the control of, and are unknown to, Challenger, so that actual results or events may vary from those forward looking statements, and the assumptions on which they are based.

While Challenger has sought to ensure that information is accurate by undertaking a review process, it makes no representation or warranty as to the accuracy or completeness of any information or statement in this document. In particular, information and statements in this document do not constitute investment advice or a recommendation on any matter, and should not be relied upon.

Key Performance Indicators

	1H15	2H14	1H14	2H13	1H13
Earnings					
Normalised NPAT ($m)	154.9	165.2	163.5	159.8	148.7
Statutory NPAT ($m)	130.1	174.3	166.3	194.8	222.0
Normalised EBIT ($m)	206.4	195.1	192.8	187.0	177.8
Underlying operating cash flow ($m)	93.6	177.6	143.4	170.4	151.1
Normalised cost to income ratio	34.4%	35.2%	34.0%	33.9%	35.0%
Normalised effective tax rate	24.3%	14.5%	14.2%	13.6%	15.1%
Normalised effective tax rate excluding TOFA[1]	24.3%	22.3%	22.1%	21.8%	23.7%
Earnings per share (cents)					
Basic – normalised	28.8	32.2	31.8	30.7	28.0
Basic – normalised excluding TOFA[1]	28.8	29.3	28.9	27.8	25.2
Basic – statutory	24.2	34.0	32.3	37.4	41.8
Diluted – normalised	27.0	30.4	30.3	30.2	27.8
Diluted – normalised excluding TOFA[1]	27.0	27.6	27.5	27.4	25.0
Diluted – statutory	22.8	32.1	30.8	36.8	41.5
Return on equity (%)					
Normalised Return on Equity (RoE) – pre-tax	17.4%	18.6%	18.9%	19.7%	19.6%
Normalised Return on Equity (RoE) – post-tax	13.2%	15.9%	16.2%	17.0%	16.6%
Statutory Return on Equity (RoE) – post-tax	11.1%	16.8%	16.5%	20.7%	24.9%
Capital management					
Net assets – average[2] ($m)	2,331	2,090	2,000	1,899	1,772
Net assets – closing ($m)	2,443	2,153	2,052	1,947	1,827
Net assets per basic share ($)	4.42	4.22	3.99	3.78	3.47
Net tangible assets ($m)	1,896	1,607	1,530	1,426	1,308
Net tangible assets per basic share ($)	3.43	3.15	2.98	2.77	2.48
Dividend (cps)	14.5	13.5	12.5	10.5	9.5
Dividend franking (%)	70.0	40.0	–	–	–
Normalised dividend payout ratio	50.4%	41.9%	39.3%	34.2%	33.9%
Share buy back ($m)	–	–	–	29.6	20.4
Sales and net flows					
Life sales ($m)					
Retail	1,574.8	1,341.8	1,457.0	1,123.9	1,055.3
Institutional	548.9	291.5	290.1	30.6	921.2
Total Life sales	2,123.7	1,633.3	1,747.1	1,154.5	1,976.5
Life retail net flows[3] ($m)	560.8	347.2	539.9	385.3	212.8
Life retail annuity book ($m)	8,573.1	7,824.3	7,617.2	7,123.3	6,819.6
Life retail net book growth[3]	7.2%	4.6%	7.6%	5.6%	3.2%
Funds Management – net flows ($m)	6,766.2	1,033.6	1,113.8	4,754.4	2,224.2
Assets under management ($m)					
Life	12,393	11,087	10,889	10,787	10,170
Funds Management	55,212	47,126	44,986	41,103	35,335
Cross holding elimination	(10,436)	(7,488)	(7,061)	(7,120)	(7,221)
Total assets under management	57,169	50,725	48,814	44,770	38,284
Other					
Headcount – closing FTEs	563	539	498	487	482
Weighted average number of basic shares on issue (m)	538.2	513.1	514.5	520.8	531.4
Number of basic shares on issue (m)	552.9	510.6	514.1	515.6	526.4
Share price closing ($)	6.53	7.44	6.20	4.01	3.54

1 Normalised tax includes the effect of a private binding tax ruling received from the ATO in February 2012 in relation to the application of Taxation of Financial Arrangements (TOFA). The TOFA private tax ruling reduces normalised tax by $15m in each period 1H13 to 2H14.
2 Average net assets calculated on a monthly basis.
3 Excludes $284m maturity of the High Yield Fund annuity in 2H14.

Consolidated profit and loss

$m	1H15	2H14	1H14	2H13	1H13
Cash earnings	223.3	214.4	211.3	209.7	206.5
Normalised capital growth	34.5	29.7	25.9	17.4	18.6
Normalised Cash Operating Earnings (COE)	**257.8**	**244.1**	**237.2**	**227.1**	**225.1**
Net fee income	56.1	56.4	53.8	54.2	45.2
Other income	0.7	0.6	1.2	1.7	3.2
Total net income	**314.6**	**301.1**	**292.2**	**283.0**	**273.5**
Personnel expenses	(76.5)	(74.8)	(69.6)	(64.9)	(65.4)
Other expenses	(31.7)	(31.2)	(29.8)	(31.1)	(30.3)
Total expenses	**(108.2)**	**(106.0)**	**(99.4)**	**(96.0)**	**(95.7)**
Normalised EBIT	**206.4**	**195.1**	**192.8**	**187.0**	**177.8**
Interest and borrowing costs	(1.7)	(1.9)	(2.2)	(1.9)	(2.7)
Normalised profit before tax	**204.7**	**193.2**	**190.6**	**185.1**	**175.1**
Normalised tax	(49.8)	(28.0)	(27.1)	(25.3)	(26.4)
Normalised profit after tax	**154.9**	**165.2**	**163.5**	**159.8**	**148.7**
Investment experience after tax	(24.8)	9.1	2.8	26.5	73.3
Significant items after tax[1]	–	–	–	8.5	–
Statutory net profit after tax	**130.1**	**174.3**	**166.3**	**194.8**	**222.0**
Performance analysis					
Normalised earnings per share – basic (cents)	28.8	32.2	31.8	30.7	28.0
Shares for basic EPS calculation	538.2	513.1	514.5	520.8	531.4
Normalised cost to income ratio	34.4%	35.2%	34.0%	33.9%	35.0%
Normalised effective tax rate	24.3%	14.5%	14.2%	13.6%	15.1%
Normalised effective tax rate excluding TOFA[2]	24.3%	22.3%	22.1%	21.8%	23.7%
Total net income analysis					
Cash earnings (Life)	71.0%	71.2%	72.3%	74.1%	75.5%
Normalised capital growth (Life)	11.0%	9.9%	8.9%	6.1%	6.8%
Net fee income (Funds Management)	17.8%	18.7%	18.4%	19.2%	16.5%
Other income (Corporate)	0.2%	0.2%	0.4%	0.6%	1.2%
Normalised EBIT by division					
Life	215.8	203.6	200.6	191.8	190.1
Funds Management	20.8	22.6	20.7	21.2	12.9
Corporate	(30.2)	(31.1)	(28.5)	(26.0)	(25.2)
Normalised EBIT	**206.4**	**195.1**	**192.8**	**187.0**	**177.8**

1 2H13 significant items after tax primarily represents the gain on sale of Challenger's equity investment in Homeloans Limited.
2 Normalised tax includes the effect of a private binding tax ruling received from the ATO in February 2012 in relation to the application of Taxation of Financial Arrangements (TOFA). The TOFA private tax ruling reduces normalised tax by $15m in each period 1H13 to 2H14.

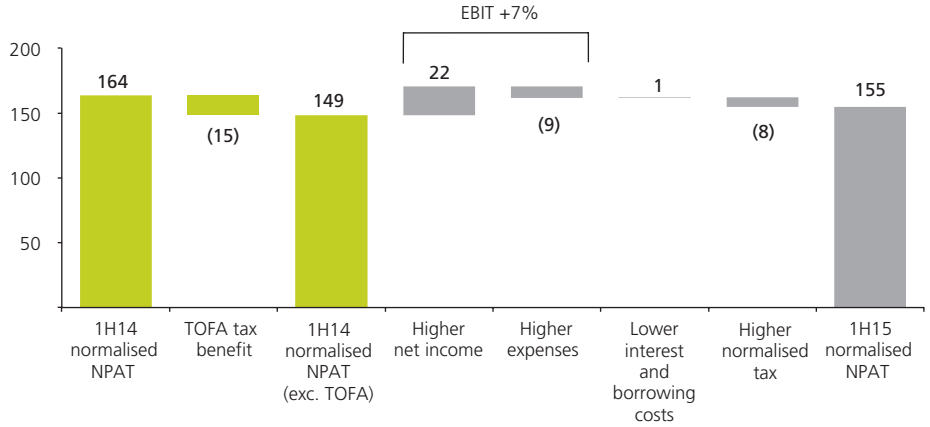
Consolidated profit and loss

Normalised net profit after tax

Normalised net profit after tax was $155m in 1H15, down 5% from $164m in 1H14 reflecting higher net income (up $22m) and lower interest costs (down $1m) offset by an increase in expenses (up $9m) and tax (up $23m). The increase in tax includes the conclusion of the Taxation of Financial Arrangements (TOFA) transitional deduction, which ended on 30 June 2014. The1H14 normalised tax was reduced by $15m for TOFA, with no corresponding TOFA benefit recognised in 1H15 (refer to page 4 for additional detail).

Excluding the TOFA impact, normalised net profit after tax increased by 4% ($6m) as a result of higher EBIT (up $13m) and lower interest and borrowing costs (down $1m), partially offset by higher normalised tax ($8m).

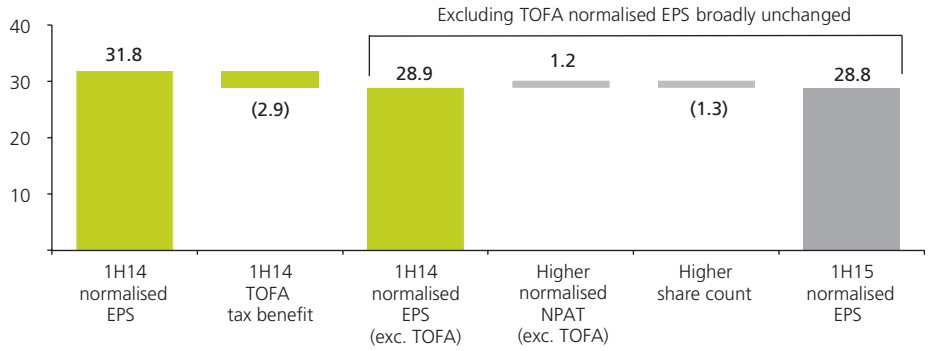
Change in normalised net profit after tax ($m)



Normalised EPS

Normalised EPS decreased by 9% from 31.8 cps in 1H14 to 28.8 cps in 1H15. The decrease in normalised EPS reflects an increase in EBIT (up 7%) offset by the conclusion of the transitional TOFA tax deductions on 30 June 2014 and a higher weighted average number of shares on issue following completion of the 1H15 capital management initiatives (refer to page 11 for additional detail). 1H14 normalised EPS excluding the TOFA tax deduction, was 28.9 cps, and is broadly in line with 1H15 normalised EPS of 28.8 cps.

Change in normalised EPS (cps)



Total net income

Total net income increased by $22m (8%) in 1H15 due to:

- higher Life Cash Operating Earnings (up $21m) as a result of growth in Life's investment assets;
- higher Funds Management net fee income (up $2m) from higher Funds Under Management (FUM); partly offset by;
- lower other income (down $1m) due to lower average cash balances.

Expenses

1H15 total expenses were $108m, up $9m (9%) on 1H14, mainly due to an increase in employee numbers to support Challenger's growth initiatives. 1H15 expenses also includes $3m in relation to Accurium (previously Bendzulla Actuarial) following its acquisition in February 2014, which was not part of the 1H14 cost base.

Challenger's full time equivalent employee numbers at 31 December 2014 was 563, which was 13% (or 65) higher than 12 months ago. The increase in employee numbers includes 23 employees following the Accurium acquisition and additional employees relating to distribution and asset origination initiatives.

Challenger's business is one of Australia's most efficient financial services companies. Over the past five years, total expenses have increased by only $21m, whilst net income has increased by $108m, resulting in the cost to income ratio falling by seven percentage points over this time.

Challenger's normalised cost to income ratio was 34.4% in 1H15, an improvement on 35.2% in 2H14 and relatively unchanged from 1H14 (34.0%).

Challenger's medium term normalised cost to income ratio target is 32% to 36%. FY15 normalised cost to income ratio is expected to be ~34%, as growth in net income is partially reinvested in the business to capture growth opportunities.

Normalised EBIT

1H15 normalised EBIT was $206m increasing $13m (7%) from $193m in 1H14.

The increase in EBIT was driven by higher Life normalised EBIT (up $15m), partially offset by lower Corporate EBIT (down $2m). Funds Management EBIT was unchanged at $21m.

The increase in Life normalised EBIT reflects growth in assets under management following strong annuity sales and net book growth. Funds Management normalised EBIT was unchanged despite strong FUM growth being offset by a lower contribution from performance fees and a change in AUM mix. The change in AUM mix includes the formation of Whitehelm Capital on 1 July 2014 and the consolidation of fixed income teams (refer to page 22 for more detail). Corporate EBIT decreased due to lower net income and higher personnel expenses.

Normalised tax

Normalised tax was $50m (effective tax rate of 24.3%) in 1H15, which was up from $27m (effective tax rate of 14.2%) in 1H14. The increase in effective tax rate primarily relates to the conclusion of the TOFA transitional deduction on 30 June 2014.

In February 2012 the Australian Taxation Office issued a private tax ruling in relation to the application of Taxation of Financial Arrangements (TOFA). The TOFA private tax ruling reduced normalised tax by approximately $30m for each of the three financial years FY12 to FY14. 1H14 normalised tax was reduced by $15m in relation to TOFA, with no TOFA tax deduction recognised in 1H15.

The normalised effective tax rate in 1H15 was 24.3%, compared to 22.1% in 1H14 excluding TOFA. The increase in the effective tax rate was due to a reduction in non-assessable items.

Challenger's medium term effective tax rate is expected to be between twenty three to twenty five percent, reflecting Challenger's earnings mix.

Investment experience

Challenger Life is required by Australian accounting standards to value assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss. Challenger is generally a long-term holder of assets, due to them being held to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on Challenger's long-term expected returns. Refer to page 33 for details on Challenger's assumed long-term expected returns by asset class.

Investment experience also includes any actuarial assumption changes, including the impact of changes in economic variables (refer to page 34 for more detail).

Investment experience relates to the Life business and pre-tax investment experience is disclosed as part of Life's financial results (refer to page 14).

1H15 after tax investment experience was a loss of $25m, compared to a profit of $3m in 1H14.

1H15 investment experience from marking Life's investment assets to market was positive $7m (after-tax). Strong property valuation gains for both directly held properties and REITs were partly offset by fixed income losses as a result of the expansion in fixed income corporate credit spreads.

The 1H15 impact of changes in actuarial assumption changes on Life's liabilities was a loss of $32m (after-tax). Refer to page 17 for more details.

Statutory net profit after tax

Statutory net profit after tax includes investment experience.

Statutory net profit after tax was $130m in 1H15, down from $166m in 1H14. The reduction in statutory net profit after tax reflects lower investment experience (down $28m) and lower normalised profit after tax (down $9m).

FY15 guidance

Retail annuity net book growth

In November 2014 Challenger announced it would discontinue the Care Annuity product in its current form as a result of the Department of Social Services redefining how the Care Annuity would be treated for social security purposes. A replacement Care Annuity product is in development and Challenger expects to re-enter the aged care market. At the time of the Department of Social Services announcement in November 2014 (refer to page 17 for more detail) Challenger withdrew its FY15 net book growth guidance (12% to 14%) until further details on the Care Annuity could be provided to the market.

The FY15 retail annuity net book growth target is now expected to grow by between 11% and 13%, with the original growth target reduced by 1% (from the initial guidance 12% to 14%). The replacement Care Annuity product is still in development and the launch date of a replacement product is still to be determined. The growth target of between 11% and 13% is not dependent on a replacement Care Annuity product being launched in 2H15.

Based on the FY14 Life retail annuity book ($7,824m – refer page 6), growth of between 11% and 13% equates to growth of between ~$850m and ~$1,000m in FY15.

Life COE

FY15 Life COE guidance is $535m to $545m and includes both the Accurium acquisitions (previously Bendzulla Actuarial – refer to page 18 for additional detail) and Life Risk reinsurance transactions undertaken (refer to page 18 for additional detail), as well as the capital management initiatives completed in 1H15 (refer to page 11 for additional detail).

Based on the mid-point of both retail net book growth guidance (between 11% and 13% growth) and COE guidance, the implied 2H15 COE margin is expected to be ~4.4% (unchanged from 1H15).

Normalised cost to income ratio

Challenger's medium term normalised cost to income ratio target is 32% to 36%.

Challenger's FY15 cost to income ratio is expected to be approximately 34%, which is broadly unchanged from FY14. An increase in total expenses is expected in FY15 in order to support the growth in Challenger's business, including costs associated with annuities on platform and expanding Life's asset origination capability.

Dividend and share buy back policy

Challenger has historically targeted a combined dividend and buy back payout ratio of approximately 50% of normalised profit after tax over the medium term, subject to prevailing market conditions and alternative uses of capital.

The Challenger Limited Board regularly reviews the mix between dividends and share buy back as part of the Group's capital management plan. With the forecasted increase in dividend franking levels, in August 2014 the Challenger Limited Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax.

Challenger's final 2015 dividend is expected to be in the range of 45% to 50% of normalised net profit after tax and 100% franked. However, the actual dividend payout ratio and franking will depend on prevailing market conditions and capital allocation priorities.

There were no shares bought back in 1H15 and Challenger does not anticipate buying back shares in 2H15.

Management balance sheet

$m	1H15	FY14	1H14	FY13	1H13
Group balance sheet[1]					
Assets					
Life investment assets					
Fixed income and cash (net)	8,541.1	7,955.7	7,983.2	8,219.2	7,974.2
Property (net)	2,716.4	2,167.8	1,952.0	1,761.1	1,540.9
Equity and other investments	632.4	400.7	433.1	318.5	227.7
Infrastructure (net)	503.0	563.2	520.9	488.4	426.9
Life investment assets	**12,392.9**	**11,087.4**	**10,889.2**	**10,787.2**	**10,169.7**
Cash and cash equivalents	126.0	141.2	154.8	177.1	135.5
Receivables	217.4	181.9	281.8	446.3	381.6
Derivative assets	356.6	326.3	245.2	336.9	438.9
Other investment assets	–	–	3.5	5.4	7.5
Investment in associates	39.4	39.4	36.4	40.0	49.8
Other assets	42.6	27.9	46.3	35.2	42.1
Fixed assets	10.9	12.4	12.3	14.5	16.0
Goodwill and intangibles	547.2	545.8	522.1	521.1	519.6
Less Group/Life eliminations[2]	(154.9)	(182.2)	(202.3)	(223.1)	(254.9)
Total assets	**13,578.1**	**12,180.1**	**11,989.3**	**12,140.6**	**11,505.8**
Liabilities					
Payables	191.0	190.7	191.7	165.4	275.1
Tax liabilities	150.4	165.7	161.2	133.9	100.5
Derivative liabilities	344.5	222.1	327.2	393.9	123.9
Subordinated debt	560.7	525.9	509.5	510.1	472.3
Challenger Capital Notes	336.2	–	–	–	–
Other interest bearing liabilities	4.0	3.2	103.8	88.2	79.9
Provisions	20.5	22.5	26.1	27.0	30.2
Life retail annuity book	8,573.1	7,824.3	7,617.2	7,123.3	6,819.6
Guaranteed index return liabilities	954.8	1,072.4	1,000.3	1,751.4	1,777.0
Total liabilities	**11,135.2**	**10,026.8**	**9,937.0**	**10,193.2**	**9,678.5**
Group net assets	**2,442.9**	**2,153.3**	**2,052.3**	**1,947.4**	**1,827.3**
Equity					
Contributed equity	1,524.3	1,237.5	1,263.2	1,271.9	1,313.5
Reserves	13.8	69.8	52.1	49.8	33.0
Retained earnings	904.8	846.0	737.0	625.7	480.8
Total equity	**2,442.9**	**2,153.3**	**2,052.3**	**1,947.4**	**1,827.3**

1 Excludes consolidation of Special Purpose Vehicles (SPV's) and non-controlling interests.
2 Group/Life eliminations represent the fair value of the SPV residual income notes (i.e. NIM) held by CLC.

Management balance sheet

$m	1H15	FY14	1H14	FY13	1H13
Life balance sheet					
Assets					
Life investment assets					
Cash and equivalents	1,307.3	1,243.7	1,331.5	1,292.7	441.3
Asset backed securities	4,082.1	3,477.2	3,425.4	3,397.3	3,593.4
Corporate credit	3,024.3	3,146.1	3,075.3	3,366.8	3,692.1
Other	127.4	88.7	151.0	162.4	247.4
Fixed income and cash (net)	**8,541.1**	**7,955.7**	**7,983.2**	**8,219.2**	**7,974.2**
Australian – Office	1,138.2	805.5	657.6	656.8	643.9
Australian – Retail	721.6	480.3	437.4	260.0	131.4
Australian – Industrial	162.8	165.1	134.6	130.6	123.7
Japanese	204.3	203.4	233.9	241.4	235.3
REITS and other	489.5	513.5	488.5	472.3	406.6
Property (net)	**2,716.4**	**2,167.8**	**1,952.0**	**1,761.1**	**1,540.9**
Equity and other investments	632.4	400.7	433.1	318.5	227.7
Infrastructure (net)	503.0	563.2	520.9	488.4	426.9
Life investment assets	**12,392.9**	**11,087.4**	**10,889.2**	**10,787.2**	**10,169.7**
Other assets (including intangibles)	601.4	659.1	490.4	612.4	847.9
Total assets	**12,994.3**	**11,746.5**	**11,379.6**	**11,399.6**	**11,017.6**
Life retail annuity book	8,573.1	7,824.3	7,617.2	7,123.3	6,819.6
Guaranteed index return liabilities	954.8	1,072.4	1,000.3	1,751.4	1,777.0
Subordinated debt	560.7	525.9	509.5	510.1	472.3
Challenger Capital Notes	345.0	–	–	–	–
Other liabilities	199.8	144.8	301.2	149.5	183.7
Total liabilities	**10,633.4**	**9,567.4**	**9,428.2**	**9,534.3**	**9,252.6**
Net assets	**2,360.9**	**2,179.1**	**1,951.4**	**1,865.3**	**1,765.0**

Life investment assets

Life investment assets support retail and institutional retirement income products and Life shareholder capital.

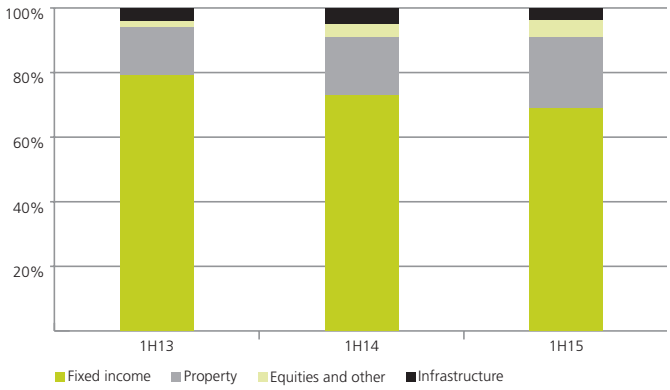
1H15 Life investment assets were $12.4bn, an increase of 12% ($1.3bn) for 1H15. The increase in Life investment assets is due to Life earnings (net of dividends to Group), annuity net flows, and capital injected into CLC following completion of the 1H15 capital management initiatives (refer to page 11 for additional details).

Life manages a cash flow matched portfolio, with liability cash flows (i.e. payments to annuitant customers) matched with cash flows from investment assets. Life has a policy to mitigate interest rate and foreign exchange risks through the use of derivatives.

Life's investment assets at 31 December 2014 comprised:

- Fixed income and cash 69%;
- Property 22%;
- Equities and other investments 5%; and
- Infrastructure 4%.

Life investment portfolio overview



Life's asset allocation reflects both the relative value of different asset classes and the tenor of annuity sales as Life runs a cash flow matched portfolio. With the continued increase in Life's longer tenor lifetime annuity sales (up 18% on 1H14), Life has been seeking investments that produce longer dated cash flows, such as property. This has resulted in an increase in the allocation to property and a reduction in fixed income.

Fixed income and cash

Fixed income and cash of $8.5bn (net of debt) represents 69% of Life's total investment assets, down from 73% in 1H14.

Challenger manages credit risk by maintaining a high quality investment portfolio and applying a rigorous investment process. The fixed income portfolio is diversified across different industries, rating bands, asset classes and geographies. The fixed income portfolio comprises over 1,100 different securities with 75% of the fixed income portfolio investment grade (i.e. BBB or higher).

A total of 75% of the fixed income portfolio is externally rated (Standard & Poor's, Fitch or Moody's) and 25% is based on internal ratings calibrated to Standard & Poor's or Moody's ratings framework.

The fixed income and cash portfolio is Australian focused, with domestic cash, domestic asset backed securities and domestic corporate credit accounting for 71% of the portfolio. Life does not have any exposure to European sovereign debt.

Realised asset losses on the fixed income portfolio in 1H15 were 2 bps, which is well below the normalised growth assumption of a 35 bps loss.

Fixed income portfolio by credit rating

Security rating	Total $m	Investment grade	Non-investment grade	Duration
Cash and equivalents	1,307	15%		n/a
AAA	1,226	15%		2 years
AA	884	10%		4 years
A	1,210	14%		4 years
BBB	1,773	21%		5 years
BB	1,182		14%	4 years
B	657		8%	6 years
Unrated	302		3%	7 years
Total	**8,541**	**75%**	**25%**	**4 years**

Property

Property of $2.7bn (net of debt) represents 22% of Life's investment assets, up from 18% in 1H14. The increase in property reflects the increase in Life's longer tenor annuity sales.

Life's property portfolio increased by $0.5bn (net of debt) during 1H15 as a result of domestic office and retail property acquisitions (refer to table below), partially offset by property disposals as part of a property remix that is currently underway.

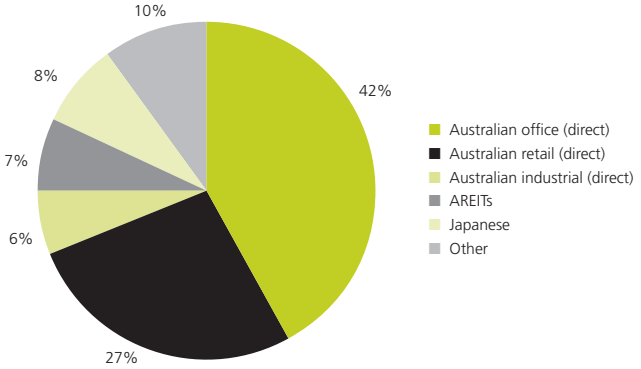
1H15 property acquisitions	$m	Detail
Exchanged and settled in 1H15 (included in 1H15 property AUM)		
53 Albert Street, Brisbane	222	Office 98%; Retail 2%
Barracks shopping centre, Brisbane	153	Office 53%; Retail 47%
Golden Grove shopping centre, Adelaide	139	Retail 100%
Total	**$514m**	**Office 58%; Retail 42%**
Exchanged in 1H15 to settle in 2H15 (not included in 1H15 property AUM)		
35 Clarence Street, Sydney	145	Office 92%; Retail 8%
565 Bourke Street, Melbourne	86	Office 96%; Retail 4%
Channel Court, Kingston	80	Retail 100%
Total	**$311m**	**Office 69%; Retail 31%**

1H15 property disposals	$m	Detail
Taylors Institute, Sydney	$40m	Settled July 2014
CSIRO, Sydney	$170m	Settled January 2015

Following the scheduled 2H15 property settlements and disposals, Life expects the property allocation to remain around current levels.

1H15 property acquisitions include $32m of stamp duty and acquisition costs. Under Australian accounting standards, property acquisition and transaction costs are required to be capitalised. When the property is subsequently revalued, there is generally no value ascribed to the acquisition costs which may result in a reduction in the property value, with a corresponding negative investment experience impact. The properties acquired in 1H15 will be subject to either an independent or director valuation in 2H15.

Property portfolio by sector



Life's property portfolio principally comprises directly held properties and investments in REITs. The Australian portfolio is diversified across office and retail properties, with a small (6%) exposure to industrial properties.

Australian properties have a weighted average lease expiry of 4.8 years and an occupancy rate of 97%. A total of 85% of the Australian portfolio has either fixed or CPI-linked rental increases, giving rise to increasing cash flows over time. Rental income is diversified across sectors and tenants, with 61% (by 2015 gross rental income) of Australian tenants classified as investment grade (i.e. rated BBB or higher). The Australian Government is a major tenant, leasing a range of commercial office buildings and is expected to account for 42% of 2015 gross rental income.

Life is currently undertaking a property remix to ensure the property portfolio delivers the required cash flows to match Life's annuity liabilities and remains a high quality and diversified portfolio. As part of the property remix, a number of properties are to be sold, including the CSIRO building in NSW ($170m), which was sold in January 2015 at book value.

Property includes a net $204m exposure to Japanese property (8% of the property portfolio), which consists of suburban shopping centres, focused on non-discretionary retailing. The weighted average lease expiry of the Japanese portfolio is 8.3 years.

Challenger Life has a policy that all properties are independently valued each year with approximately 50% valued in June and 50% valued in December. Internal valuations are also undertaken for properties not independently valued each June and December. An independent valuation is subsequently undertaken if the internal valuation shows a significant variance to the most recent independent valuation.

In 1H15 independent valuations were undertaken for 50% of properties within the portfolio. The weighted average capitalisation rate of the Australian property portfolio was 7.6% at 31 December 2014.

Equity and other investments

Equity and other investments of $0.6bn represent 5% of Life's total investment assets and include domestic and international listed and unlisted equity investments. Equity investments provide diversification across the investment portfolio.

Infrastructure

Infrastructure of $0.5bn (net of debt) represents 4% of Life's investment assets.

Challenger Life seeks infrastructure assets that generate reliable and consistent cash flows, which are preferably inflation linked, giving rise to sustainable income growth over time. Infrastructure investments comprise directly held infrastructure assets and indirectly held listed and unlisted investments. Approximately 75% of the infrastructure portfolio is held in unlisted investments.

The infrastructure portfolio is diversified across a number of geographic regions and sectors. Approximately two thirds of the portfolio is invested in logistics, utility and patronage assets, predominately in Australia, UK and Europe.

Capital management

Challenger Life Company (CLC) regulatory capital

$m	1H15	FY14	1H14	FY13	1H13
CLC's excess capital under LAGIC					
Common Equity Tier 1 (CET1) regulatory capital	1,886.7	1,783.1	1,719.0	1,563.5	1,465.8
Additional Tier 1	345.0	–	–	–	–
Tier 2 regulatory capital – subordinated debt[1]	504.7	476.8	486.8	488.8	477.3
CLC total regulatory capital base	**2,736.4**	**2,259.9**	**2,205.8**	**2,052.3**	**1,943.1**
CLC prescribed capital amount (PCA)					
Asset risk charge	1,718.0	1,530.5	1,517.0	1,452.4	1,324.1
Insurance risk charge	143.5	83.9	68.5	31.6	26.8
Operational risk charge	23.9	22.8	20.6	18.5	17.5
Aggregation benefit	(108.5)	(64.7)	(53.2)	(24.8)	(21.2)
CLC Prescribed capital amount – excluding transition relief	**1,776.9**	**1,572.5**	**1,552.9**	**1,477.7**	**1,347.2**
Transition relief	(215.2)	(215.2)	(322.8)	(322.8)	(322.8)
CLC prescribed capital amount	**1,561.7**	**1,357.3**	**1,230.1**	**1,154.9**	**1,024.4**
CLC excess over prescribed capital amount	**1,174.7**	**902.6**	**975.7**	**897.4**	**918.7**
PCA ratio (times)	**1.75**	**1.66**	**1.79**	**1.78**	**1.90**
CET1 ratio (times)	**1.21**	**1.31**	**1.40**	**1.35**	**1.43**
Tier 1 ratio (times)	**1.43**	**1.31**	**1.40**	**1.35**	**1.43**

Tier 2 regulatory capital – subordinated debt[1] **First call date after 1 Jan 2013**	**Maturity date**	**1H15**	**FY14**	**1H14**	**FY13**	**1H13**
7 Jun 2013	7 Dec 2016	88.3	77.6	107.2	103.2	109.4
7 Dec 2016	7 Dec 2026	31.0	27.5	28.3	28.0	24.2
7 Nov 2017	7 Nov 2037	385.4	371.7	351.3	357.6	343.7
		504.7	**476.8**	**486.8**	**488.8**	**477.3**

Group cash, CLC debt facilities and Group net assets

$m	1H15	FY14	1H14	FY13	1H13
Group cash	**126.0**	**141.2**	**154.8**	**177.1**	**135.5**

CLC debt facilities

Controlled property debt	679.2	721.4	823.1	845.6	857.9
Subordinated debt	560.7	525.9	509.5	510.1	472.3
Repurchase agreements	1,163.3	978.3	729.2	448.9	235.7
Infrastructure debt	205.0	206.1	206.1	206.1	206.1
Loan note finance	3.3	3.2	103.8	88.2	79.9
Total CLC debt facilities	**2,611.5**	**2,434.9**	**2,371.7**	**2,098.9**	**1,851.9**

Change in Group net assets

$m	1H15	2H14	1H14	2H13	1H13
Opening net assets	**2,153.3**	**2,052.3**	**1,947.4**	**1,827.3**	**1,692.2**
Statutory net profit after tax	130.1	174.3	166.3	194.8	222.0
Dividends paid	(71.3)	(65.3)	(55.0)	(49.9)	(55.7)
Share buy-back	–	–	–	(29.6)	(20.4)
New share issue	287.2	–	–	–	–
Reserve movements	(56.0)	17.7	2.3	16.8	(31.7)
CPP Trust movements	(0.4)	(25.7)	(8.7)	(12.0)	20.9
Closing net assets	**2,442.9**	**2,153.3**	**2,052.3**	**1,947.4**	**1,827.3**

1 1H15 subordinated debt ($505m) differs to the management balance sheet ($561m) due to inadmissible sub-debt ($59m) less accrued interest and amortised costs ($3m).

Capital management

Challenger Life Company Limited (CLC) regulatory capital base

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory and contractual obligations to customers. CLC is regulated by the Australian Prudential Regulation Authority (APRA) and is required to hold a minimum level of regulatory capital.

CLC's regulatory capital base and prescribed capital amount have been calculated based on regulatory capital standards issued by APRA. APRA issued new capital standards in October 2012 (LAGIC standards) which became effective from 1 January 2013. CLC's regulatory capital disclosures have been prepared based on LAGIC capital standards.

CLC's excess capital above APRA's prescribed capital amount at 31 December 2014 (1H15) was $1.2bn, an increase of $0.3bn for the half year. The increase in excess regulatory capital was due to increased retained earnings and the capital management initiatives completed in 1H15, partially offset by higher capital requirements as a result of Life's net book growth and increased property assets.

CLC excess regulatory capital and Group cash

CLC's excess regulatory capital plus Group cash at 31 December 2014 was $1.3bn, up $0.3bn from $1.0bn at 30 June 2014. The increase in excess regulatory capital and Group cash is due to the 1H15 capital management initiatives undertaken, operating earnings less dividends to Group, offset by higher capital requirements from net book growth and the increase in property assets.

The change in CLC's excess capital position over 1H15 includes an increase in the prescribed capital amount to reflect Life's 1H15 net book growth ($561m or 7.2% net book growth for 1H15) and higher capital intensity following a change in investment asset mix. At 30 June 2014 property accounted for 20% of Life's investment portfolio, which increased to 22% at 31 December 2014 following $0.5bn of property acquisitions in 1H15. There was a corresponding reduction in fixed income investments, reducing from 72% of the investment portfolio at 30 June 2014 to 69% at 31 December 2014.

Property investment assets require a higher prescribed capital amount than fixed income investments. As a result, following the increased allocation to property, CLC's PCA is higher and excess capital position lower.

In addition to the $0.5bn of property acquired in 1H15, Life has exchanged on an additional $0.3bn of property which is expected to settle in 2H15. In accordance with APRA prudential standards, CLC's 31 December 2014 PCA includes the $0.3bn of unsettled property as a property asset. As such, CLC's PCA is higher and excess capital position lower as it contemplates the property settlements expected in 2H15. CLC's 31 December 2014 PCA also includes capital in relation to an expected property disposal in 1H15 ($0.2bn).

CLC's 31 December 2014 excess capital position ($1.2bn) includes a LAGIC transition balance of $215m. Half of the remaining LAGIC transition balance ($108m) amortised on 1 January 2015, with the remainder of the LAGIC transition balance amortising on 1 January 2016.

CLC's PCA ratios at 31 December 2014 were as follows:

- CLC excess capital to PCA ratio of 1.8 times (APRA minimum 1.0 times);
- Common Equity tier 1 (CET1) to PCA ratio of 1.2 times (APRA minimum 0.6 times);
- Additional Tier 1 Equity to PCA ratio of 0.2 times; and
- Tier 2 Equity to PCA ratio of 0.3 times.

CLC's CET1 ratio to PCA is 1.2 times and is significantly higher than APRA's prudential requirement. APRA requires CET1 capital to be at least 60% of the PCA and total Tier 1 capital to be at least 80% of the PCA. Following the 1H15 capital management initiatives, CLC's CET1 ratio provides significant capacity to fund future growth via Additional Tier 1 or Tier 2 instruments.

1H15 capital management initiatives

Challenger Life is growing strongly and expects to materially increase the size of its retail annuity business. Challenger Life's market opportunity and growth profile is set out on pages 18 and 19. In order to support Challenger's growth profile, the following the capital management initiatives were completed in 1H15:

- $250m institutional equity placement was undertaken on 20 August 2014 with 33.2m shares issued. The placement price of $7.53 per share represented a 1.1% discount to the 10 day volume weighted average price (adjusted for the FY14 final dividend);
- $40m Share Purchase Plan (SPP) was undertaken providing eligible retail Australian and New Zealand investors the opportunity to participate. The SPP was completed in October 2014 with an issue price of $7.10 per share. More than 3,500 existing retail investors participated and Challenger issued 5.7m new shares; and
- $345m raised via Challenger Capital Notes, which are subordinated unsecured convertible notes issued by Challenger Limited. Challenger Capital Notes are quoted and tradable on the ASX (code 'CGFPA') and pay franked distributions on a quarterly basis at a margin of 3.40% p.a. over the Australian 90 day Bank Bill Rate. Distributions can be paid to note holders as a combination of cash and franking credits.

The proceeds from Challenger Capital Notes ($345m) have been injected to CLC as Additional Tier 1 Equity. The majority of the proceeds ($150m) from the institutional equity placement and SPP have been injected into CLC as Common Equity Tier 1 capital, with the remainder ($140m) retained at Group.

The 1H15 capital management initiatives will fund Life's growth initiatives whilst providing capital flexibility.

Subordinated debt

CLC's total regulatory capital base includes $505m of admissible subordinated debt. Subordinated debt issued prior to 1 January 2013 (implementation date of new LAGIC capital standards) will continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date[1] after 1 January 2013, and will then amortise over four years.

CLC's subordinated debt includes $147m which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $88m (i.e. 60% of the total amount) is included as Tier 2 regulatory capital on 31 December 2014.

The largest tranche of CLC's existing subordinated debt is a $385m tranche with a call date in November 2017. As such, this tranche will continue to be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

CLC target surplus

CLC maintains a target level of capital representing APRA's prescribed capital amount plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over and above APRA's minimum requirement.

CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions and to ensure sufficient capital is maintained to cover longevity risk. CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

While CLC does not target a specific PCA ratio, CLC's internal capital models generate a PCA ratio based upon asset allocation and economic circumstances which is currently in the range of 1.4 to 1.6 times. This range will change over time.

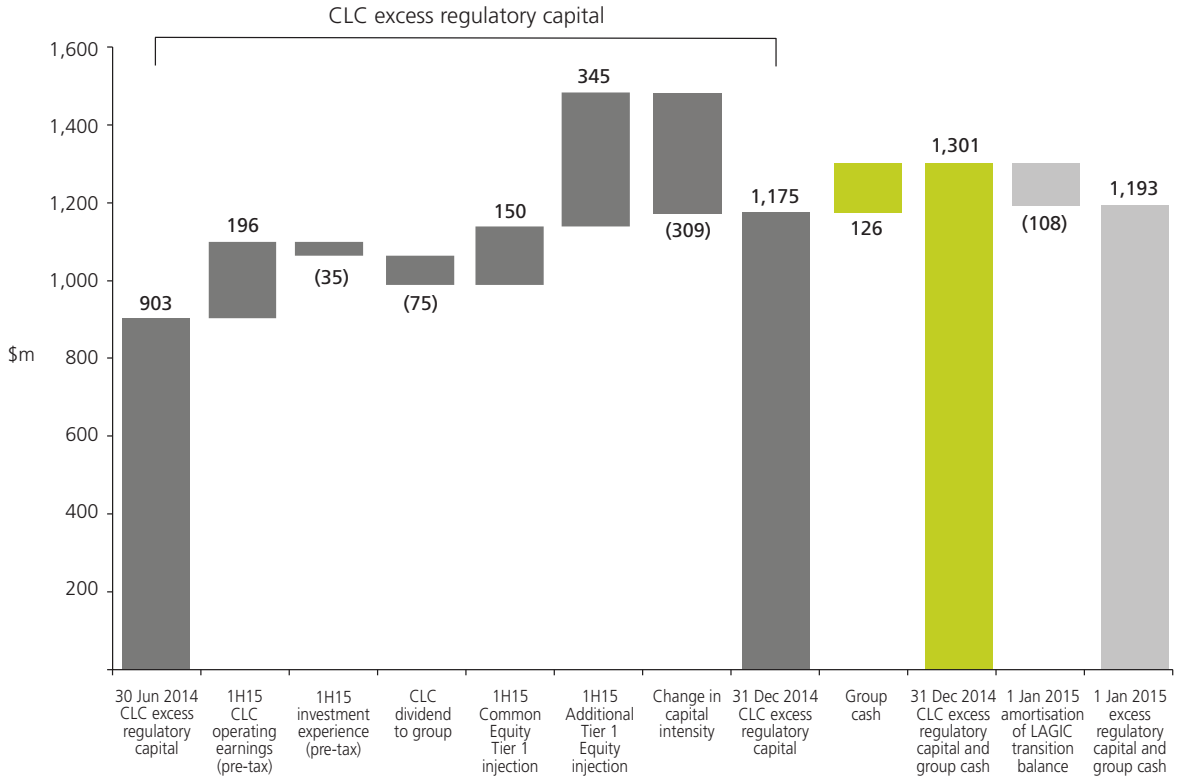
CLC's PCA ratio at 31 December 2014 was 1.8 times, up from 1.7 times at 30 June 2014 as a result of an increase in retained earnings and the 1H15 capital management initiatives completed, partially offset by a higher capital requirement following book growth and an increase in property assets, including committed property acquisitions.

CLC's PCA ratio is currently higher than the targeted range of 1.4 to 1.6 times, as CLC's capital position contemplates the amortisation of the LAGIC transition balance of $108m on1 January 2015 and 1 January 2016.

Group cash

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level, which can be utilised to meet regulatory requirements.

Change in CLC excess regulatory capital and Group cash



1 For tranches already past their call date, under LAGIC the first coupon date is considered the first call date.

Group cash at 31 December 2014 was $126m, down $15m for the half year. The movement in Group cash predominately relates to operating cash flows, 1H15 capital management initiatives (net of capital injected into CLC) and dividends paid to shareholders.

Challenger has an undrawn Group banking facility of $350m (up from $250m in 1H14) which is maintained to provide additional financial flexibility. The banking facility was undrawn throughout 1H15.

APRA's Level 3 (conglomerate) proposals

APRA is currently developing a supervisory framework for Level 3 (conglomerate) groups, which was due to be effective from 1 January 2015. Level 3 are groups of companies that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA-regulated industries.

Draft Level 3 standards have been issued by APRA. However, APRA is yet to confirm the implementation date. Based on the draft Level 3 standards issued by APRA, Challenger does not expect any material impact on its regulatory capital base.

In August 2014 APRA deferred a decision on its Level 3 final capital standards and implementation until the Government responds to the recommendations of the Financial System Inquiry.

CLC debt facilities

CLC debt facilities represent debt which is non-recourse to the Challenger Group and is secured against assets of CLC, including direct properties, repurchase agreements and infrastructure investments.

Change in Group net assets

1H15 Group net assets were $2,443m, up from $2,153m over the half year. The increase in Group net assets is due to the capital management initiatives completed in 1H15 (refer to page 11 for more detail), the half year statutory net profit after tax (including investment experience), partially offset by dividends to shareholders and reserve movements.

Dividends and share buy back

Dividend

An interim 2015 dividend of 14.5 cents per share (70% franked) has been declared, up 16% on the 2014 interim dividend.

The increase in dividend reflects an increase in the dividend payout ratio. As part of its capital management plan review in August 2014, which included consideration of the recommencement of dividend franking, the Challenger Limited Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised profit after tax.

The 2015 interim dividend payout ratio was 50.4%, up from 39.3% for the 2014 interim dividend, and is at the upper end of Challenger's dividend payout ratio guidance range.

Challenger recommenced dividend franking for the final 2014 dividend, which was 40% franked. The interim 2015 dividend is 70% franked (10.15 cps franked), with franking levels expected to increase to 100% for the final 2015 dividend. However, actual franking levels will depend on market conditions and resultant capital gains and losses that may restrict available franking credits.

There is no dividend reinvestment plan in operation for the 2015 interim dividend.

The 2015 interim dividend dates are as follows:

- Ex-date: 2 March 2015;
- Record date: 4 March 2015; and
- Payment date: 31 March 2015.

Challenger's franking account balance at 31 December 2014 was $61m, up from $24m at 30 June 2014.

Dividend and share buy back policy

Challenger has historically targeted a combined dividend and buy back payout ratio of approximately 50% of normalised profit after tax over the medium term, subject to prevailing market conditions and alternative uses of capital.

The Challenger Limited Board regularly reviews the mix between dividends and share buy back as part of the Group's capital management plan. With the forecasted increase in dividend franking levels, in August 2014 the Challenger Limited Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax. However, the actual dividend payout ratio will depend on prevailing market conditions and capital allocation priorities.

There were no shares bought back in 1H15 and Challenger does not anticipate buying back shares in 2H15.

Credit ratings

In December 2014, Standard & Poor's (S&P) affirmed both Challenger Life Company Limited's (CLC) and Challenger Limited's ratings.

Ratings were confirmed as:

- CLC: 'A' with a stable outlook; and
- Challenger Limited: 'BBB+' with a stable outlook.

The S&P ratings reflect the financial strength of Challenger Limited and CLC. In particular they demonstrate Challenger's strong business profile, earnings and capital position.

Life financial results

$m	1H15	2H14	1H14	2H13	1H13
Investment yield – policyholders' funds	375.6	365.7	374.5	375.2	386.1
Interest expense	(204.7)	(197.4)	(199.6)	(195.9)	(203.0)
Fees and commissions	(14.0)	(15.0)	(15.2)	(12.2)	(12.8)
Other income[1]	9.0	9.9	0.8	–	–
Product cash margin	**165.9**	**163.2**	**160.5**	**167.1**	**170.3**
Investment yield – shareholders' funds	57.4	51.2	50.8	42.6	36.2
Cash earnings	**223.3**	**214.4**	**211.3**	**209.7**	**206.5**
Normalised capital growth	34.5	29.7	25.9	17.4	18.6
Normalised Cash Operating Earnings (COE)	**257.8**	**244.1**	**237.2**	**227.1**	**225.1**
Personnel expenses	(25.4)	(24.3)	(21.3)	(19.6)	(19.5)
Other expenses	(16.6)	(16.2)	(15.3)	(15.7)	(15.5)
Total expenses	**(42.0)**	**(40.5)**	**(36.6)**	**(35.3)**	**(35.0)**
Normalised EBIT	**215.8**	**203.6**	**200.6**	**191.8**	**190.1**
Investment experience	(35.4)	14.1	4.1	37.8	100.3
Net profit after investment experience before tax	**180.4**	**217.7**	**204.7**	**229.6**	**290.4**
Reconciliation of investment experience to capital growth					
Investment experience	(35.4)	14.1	4.1	37.8	100.3
Normalised capital growth	34.5	29.7	25.9	17.4	18.6
Capital growth	**(0.9)**	**43.8**	**30.0**	**55.2**	**118.9**
Performance analysis					
Cost to income ratio[2]	16.3%	16.6%	15.4%	15.5%	15.5%
Net assets – average[3]	2,270	2,065	1,908	1,815	1,707
Normalised RoE (pre-tax)	18.9%	19.9%	20.9%	21.4%	22.1%

1 Other income includes Accurium revenue and Life Risk (premiums net of claims).
2 Cost to income ratio calculated as total expenses divided by Normalised Cash Operating Earnings.
3 Net assets – average is calculated based on period opening and closing balances.

$m	1H15	2H14	1H14	2H13	1H13
Sales					
Fixed Term sales	1,255.6	998.9	1,186.8	967.6	954.7
Lifetime sales	319.2	342.9	270.2	156.3	100.6
Life retail sales	**1,574.8**	**1,341.8**	**1,457.0**	**1,123.9**	**1,055.3**
Maturities and repayments[1]	(1,014.0)	(994.6)	(917.1)	(738.6)	(842.5)
Life net retail flows[1]	**560.8**	**347.2**	**539.9**	**385.3**	**212.8**
Life retail annuity book	8,573.1	7,824.3	7,617.2	7,123.3	6,819.6
Retail annuity net book growth[1]	**7.2%**	**4.6%**	**7.6%**	**5.6%**	**3.2%**
Institutional sales	548.9	291.5	290.1	30.6	921.2
Maturities and repayments	(671.3)	(250.5)	(1,042.1)	(39.4)	(953.7)
Life net institutional flows	**(122.4)**	**41.0**	**(752.0)**	**(8.8)**	**(32.5)**
Assets					
Closing investment assets	**12,393**	**11,087**	**10,889**	**10,787**	**10,170**
Fixed income and cash[2]	8,234	7,911	7,964	8,102	7,690
Property	2,385	2,036	1,870	1,606	1,517
Infrastructure	512	533	504	438	531
Equity and other investments	511	423	371	246	194
Average investment assets[3]	**11,642**	**10,903**	**10,709**	**10,392**	**9,932**
Liabilities					
Closing liabilities – annuities, GIR, capital notes and sub debt	**10,436**	**9,425**	**9,127**	**9,385**	**9,069**
Average liabilities – annuities and GIR	9,107	8,617	8,623	8,667	8,463
Average liabilities – capital notes	148	–	–	–	–
Average liabilities – sub debt	543	525	509	491	465
Average liabilities[3]	**9,798**	**9,142**	**9,132**	**9,158**	**8,928**
Margins[4]					
Investment yield – policyholders' funds	6.4%	6.8%	7.0%	7.3%	7.7%
Interest expenses	(3.5%)	(3.7%)	(3.7%)	(3.8%)	(4.1%)
Fees and commissions	(0.3%)	(0.3%)	(0.3%)	(0.2%)	(0.2%)
Other income	0.2%	0.2%	–	–	–
Product cash margin	**2.8%**	**3.0%**	**3.0%**	**3.2%**	**3.4%**
Investment yield – shareholders' funds	1.0%	1.0%	0.9%	0.8%	0.7%
Cash earnings	**3.8%**	**4.0%**	**3.9%**	**4.1%**	**4.1%**
Normalised capital growth	0.6%	0.5%	0.5%	0.3%	0.4%
Normalised Cash Operating Earnings (COE)	**4.4%**	**4.5%**	**4.4%**	**4.4%**	**4.5%**

1 2H14 maturities and repayments, Life net retail flows and retail annuity net book growth excludes maturity of the High Yield Fund annuity ($284m).
2 Includes NIM (1H15: $168m, 2H14: $193m, 1H14: $212m, 2H13: $239m, 1H13: $276m).
3 Average investment assets and average liabilities are calculated on a monthly basis.
4 Ratio of Normalised Cash Operating Earnings components divided by average investment assets.

Life financial results

CLC is Australia's leading provider of annuities and guaranteed retirement income products. Products appeal to investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks. Products are distributed via financial advisers, both independent and part of the major hubs. Being an independent manufacturer, CLC's products are included on all major hubs.

CLC has won the Association of Financial Advisers/Plan for Life annuity provider of the year for the past six years and has won the income stream innovation award for the past four years.

The Life business includes Accurium (previously Bendzulla Actuarial), the leading provider in Self Managed Superannuation Fund (SMSF) actuarial certificates which was acquired in February 2014 (refer to page 18 for additional detail).

CLC is diversifying its capital and earnings base by participating in wholesale reinsurance longevity and mortality transactions (refer to page 18 for additional detail). Life is experienced in managing, pricing and reinsuring longevity risk. Undertaking wholesale longevity and mortality reinsurance transactions is a natural business extension for Life.

CLC is an APRA regulated entity and its financial strength is rated by Standard & Poor's with an 'A' rating and stable outlook. CLC is strongly capitalised with significant excess capital above APRA's minimum requirements. CLC's regulatory capital base and excess capital above prescribed capital amount is disclosed on page 10.

Normalised EBIT and RoE

1H15 normalised EBIT increased by $15m (8%) to $216m due to higher normalised cash operating earnings (up $21m), partly offset by higher expenses (up $6m).

1H15 Life RoE (pre-tax) was 18.9% down from 20.9% in 1H14 due to a higher capital base following the 1H15 capital management initiatives (refer page 11 for additional details) and increase in retained earnings. Challenger is committed to its 18% (pre-tax) RoE target and expects to meet this target as capital is fully deployed.

Normalised Cash Operating Earnings (COE) and COE margin

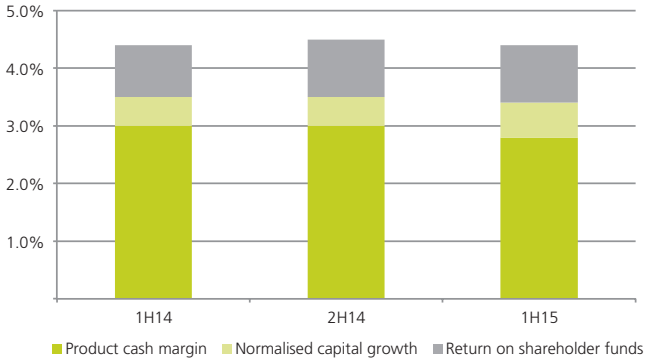
1H15 normalised COE increased by 9% to $258m. The increase in normalised COE is a result of higher average investment assets, with Life's margin stable at 4.4%. Average investment assets were 9% higher than in 1H14.

1H15 normalised COE includes Accurium (previously Bendzulla Actuarial) revenue of $5m (1H14 nil) and net income on Life Risk reinsurance transactions of $4m (1H14 $1m). Life Risk net income represents premiums net of expected claims.

The 1H15 COE margin was 4.4%, which is unchanged from 1H14 and down 0.1% from 2H14. The 1H15 COE margin includes the following:

- Product cash margin of 2.8%, down 0.2% on 2H14. The product cash margin reduced due to lower asset returns, partially offset by a reduction in annuity funding costs. Product margin includes a contribution from Accurium (previously Bendzulla Actuarial) and Life Risk of 0.2% (refer to page 18 for additional detail).
- Return on shareholder funds of 1.0%, which was unchanged from 2H14. Despite higher average shareholder assets following the capital management initiatives, return on shareholder funds in 1H15 was unchanged. Higher average shareholder capital was offset by lower investment returns due to the low interest rate environment. Shareholder capital is not hedged for movements in interest rates.
- Normalised capital growth of 0.6%, up 0.1% on 2H14. The increase reflects a higher proportion of Life's investment portfolio invested in property. Property as a portion of average investment assets was 20% in 1H15, up from 17% in 1H14. The increase in property reflects an increase in longer tenor annuity sales, as property delivers longer dated asset backed cash flows.

Life COE margin composition



Expenses

1H15 total expenses were $42m, up $6m (15%) on 1H14. The increase in expenses is due to the acquisition of Accurium (previously Bendzulla Actuarial) in February 2014 (1H15 includes $3m of Accurium expenses) and an increase in Life employee numbers to support business growth. Life has added employee numbers to build out its asset origination capability and to support distribution initiatives, including annuities on platform capability.

Investment experience

Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on Challenger's long-term expected returns. Investment experience also includes any actuarial assumption changes, including the impact of changes in economic variables (refer to page 34 for additional detail).

1H15 investment experience was a loss of $35m (pre-tax), comprising $11m (pre-tax) from investment assets, offset by a $46m loss (pre-tax) from actuarial assumption changes.

1H15 actual capital growth on Life's investment assets was $46m and expected gains (i.e. normalised growth) was $35m, resulting in positive investment experience on Life's investment assets of $11m. Positive asset investment experience was driven by property valuation gains on both directly held properties and listed REITs (combined gain of $52m), partially offset by losses on fixed income (loss of $31m) due to an expansion in corporate credit spreads.

Actuarial assumption changes (loss of $46m) represent the impact of mark-to-market on policy liabilities, including expense reserves and changes in macroeconomic variables, including interest rates and inflation. 1H15 actuarial assumption changes ($46m) mainly relate to the fair value adjustment applied to our new business. This arises as the actual funding cost of new business is higher than the risk free discount rate applied when valuing policy liabilities. This difference is recognised as a loss at time of sale which reverses over the future term of the policy.

1H15 investment experience

Asset class ($m)	Actual capital growth	Normalised capital growth	Investment experience
Fixed income	(45m)	(14m)	(31m)
Property	75m	23m	52m
Infrastructure	17m	11m	6m
Equity and other	(1m)	15m	(16m)
Actuarial adjustments	(46m)	–	(46m)
Total	**–**	**35m**	**(35m)**

Sales and AUM

1H15 Life retail annuity sales were $1.6bn, representing an 8% increase on 1H14 and were a record half yearly retail annuity sales result.

Retail annuity sales continue to benefit from favourable macroeconomic trends, including an ageing population and retirees taking a more conservative approach to investing in retirement. These favourable macroeconomic trends are being leveraged by Challenger's product innovation and extensive distribution footprint.

Lifetime annuity sales (i.e. Liquid Lifetime and Care Annuity) continued to grow strongly and were $319m in 1H15, up from $270m in 1H14. Lifetime annuity sales represent 20% of total 1H15 retail annuity sales, doubling from 10% two years ago (1H13).

Care Annuity sales in 1H15 were $100m, which was down from $127m in 1H14. Care Annuity product sales were suspended in November 2014 following the Department of Social Services decision to redefine how the Care Annuity would be treated for social security purposes. Existing Care Annuity customers are not impacted and in order to reduce future uncertainty, Challenger discontinued the Care Annuity in its current form. The aged care market is an attractive market and Challenger is currently working on a replacement product and expects to re-enter this market.

Retail annuity sales are benefiting from consistently strong reinvestment rates for term annuities with a residual capital value. Term annuity reinvestments in 1H15 were $321m, or 20% of total retail annuity sales.

1H15 retail annuity net flows (i.e. annuity sales less capital repayments) were $561m, up from $540m in 1H14. Based on the closing FY14 Life retail annuity book ($7,824m), retail annuity net book growth in 1H15 was 7.2%, down from 7.6% in 1H14. Excluding Care Annuity (sales suspended in November 2014), 1H15 net book growth was 6.3%.

1H15 institutional sales represent Challenger's Guaranteed Index Return (GIR) product. 1H15 sales were $549m and mainly represent the reinvestment of GIR maturities, which were reinvested for a longer tenor.

Life's 1H15 investment assets (AUM) was $12.4bn, up 14% ($1.5bn) on 1H14. The increase in investment assets is due to Life earnings (net of dividends to Group), retail annuity net flows, and capital injected into CLC following completion of the 1H15 capital management initiatives (refer to page 11 for additional detail).

For additional Life sales and AUM commentary, refer to the Assets Under Management and sales detail commencing on page 25.

Capital management

Refer to page 11 for details on CLC's regulatory capital base and excess capital above prescribed capital amount.

Accurium (Bendzulla Actuarial) acquisition

In February 2014 Challenger completed the acquisition of Bendzulla Actuarial for $25m and the business was rebranded Accurium in 1H15.

Accurium is Australia's leading provider of Self Managed Superannuation Fund (SMSF) actuarial certificates. An actuarial certificate is required by an SMSF when one (or more) members are in the retirement phase of superannuation and one (or more) is in the savings phase of superannuation. Accurium has approximately 60% of the SMSF actuarial certificate market share, with the market expected to increase by over 10% per annum for the next ten years as Baby Boomers (born 1946 to 1964) retire.

The Accurium acquisition was a strategic investment for Challenger, with the business rebranded and repositioned in 1H15. Accurium's vision is to become Australia's SMSF retirement specialist and is leveraging existing relationships with Australian SMSF practitioners to increase the level of engagement and education in terms of retirement solutions within the SMSF sector.

In 1H15 Accurium launched SMSF retirement income research to focus on SMSF retirement issues. The research shows one quarter of SMSFs have insufficient assets to generate retirement incomes of $100,000 per year.

In 1H15 Accurium also developed the 'Accurium retirement healthcheck' for its SMSF practitioner clients, in order to help build an understanding of the sustainability of retirement spending and build an understanding of other retirement issues, including life expectancy, market performance and inflation. The Accurium retirement healthcheck will be formally launched in early 2H15.

Life's 1H15 financial results include Accurium, with revenue of $5m in 1H15 reported as other income in Life's COE framework, and expenses of $3m in 1H15 included in Life's expenses.

Life Risk

Challenger's lifetime annuity sales are growing strongly, increasing by 18% in 1H15. Lifetime annuities provide guaranteed payments to customers for life. Through selling lifetime annuities, CLC is assuming longevity risk, which is the risk that annuitant customers live longer, in aggregate, than expected.

Life insurance risk adds valuable earnings and risk diversification. Historically the capital standards applicable to Life Company's rendered retaining these risks uneconomic. However the LAGIC capital standards (implemented 1 January 2013) include an aggregation benefit which rewards diversification of risk across asset and life insurance risks. Based on Life's current mix of business, the aggregation benefit reduces the insurance risk charge by approximately 80%. As a result, longevity risk provides CLC with earnings diversification in a highly RoE accretive way. For additional details on CLC's regulatory capital requirements and prescribed capital amount across insurance and asset risks, refer to the capital management disclosures on page 11.

In addition to the organic growth in longevity risk, CLC has participated in a number of wholesale longevity and mortality risk transactions (Life Risk). Mortality is the risk that people die earlier than expected and is a natural hedge to longevity risk (the risk that people live longer than expected).

CLC has participated in Life Risk reinsurance transactions, providing exposure to UK/European longevity and mortality, North American mortality, and Australian mortality. All transactions have been executed via reinsurance and swap transactions, and assume no asset risk. In 1H15 one life risk transaction was executed, providing exposure to the UK longevity market.

1H15 Life COE includes $4m as a result of Life Risk transactions, with FY15 Life COE guidance assuming $10m in relation to Life Risk transactions. At 31 December 2014, the present value of future profits arising from Life Risk transactions was $182m, representing the present value of expected future cash inflows (premiums) and cash outflows (claims). The Life Risk portfolio has an average duration of 12 years.

Undertaking wholesale longevity and mortality transactions is a natural business extension for Life. Life is experienced in pricing, managing and reinsuring longevity risk and is participating in these transactions alongside global reinsurers and investment banks.

Life Risk transactions provide Life with earnings diversification in a highly accretive way.

Outlook

The Australian retirement incomes market is expected to grow strongly over the next 20 years as Australia's Baby Boomers (born 1946 to 1964) move from retirement 'saving' to retirement 'spending'. Over this period, the number of Australians over 65, which is Life's target demographic, will increase by 75%.

Challenger Life is well positioned to benefit from changes in retiree risk preferences, including increased focus on longevity risk by retirees. Annuities address many of the financial concerns retirees face. Demand for annuity products is being amplified through Challenger's market-leading distribution, product innovation and strong retirement incomes brand recognition.

Challenger is also investing in technology to allow annuities to easily integrate with account-based pensions as there is a growing acceptance annuities are part of the optimal retirement income strategy. Integrating annuities with account-based pensions support income layering and enable retirement income model portfolios to provide guaranteed incomes. In 1H15 Challenger announced strategic partnerships with Colonial First State and VicSuper to integrate Challenger annuities into their platforms and product offerings. Challenger expects to announce further partnerships, which will drive additional long term annuity sales and business growth.

The Australian Federal Government commissioned the Financial System Inquiry to provide a 'blueprint' for Australia's financial system over the next decade. The final Financial System Inquiry report recommended the retirement phase of superannuation would benefit greatly from pre-selected retirement products for members that provide regular and stable income streams with longevity protection. Annuities provide stable incomes and provide longevity protection and could be part of pre-selected retirement products offered by superannuation funds.

As Australia's leading retirement income specialist, Challenger is uniquely positioned to further benefit should the Government adopt the Financial System Inquiry recommendations.

Funds Management financial results

$m	1H15	2H14	1H14	2H13	1H13
Fidante Partners					
Fidante Partners income[1]	18.7	18.7	15.0	17.9	13.9
Equity accounted profits[2]	13.4	15.1	16.1	11.2	4.9
Net income	**32.1**	**33.8**	**31.1**	**29.1**	**18.8**
Challenger Investment Partners					
Net management fees	17.2	20.4	19.1	19.4	21.6
Performance and transaction fees	6.8	2.2	3.6	5.7	4.8
Net income	**24.0**	**22.6**	**22.7**	**25.1**	**26.4**
Total net fee income	**56.1**	**56.4**	**53.8**	**54.2**	**45.2**
Personnel expenses	(24.8)	(24.4)	(23.4)	(23.0)	(22.8)
Other expenses	(10.5)	(9.4)	(9.7)	(10.0)	(9.5)
Total expenses	**(35.3)**	**(33.8)**	**(33.1)**	**(33.0)**	**(32.3)**
EBIT	**20.8**	**22.6**	**20.7**	**21.2**	**12.9**
Performance analysis					
Fidante Partners – income margin (bps)[3]	16	20	20	21	18
Challenger Investment Partners – income margin (bps)[3]	39	41	40	44	45
Cost to income ratio	62.9%	59.9%	61.5%	60.9%	71.5%
Net assets – average[4]	127.1	134.3	131.0	127.4	130.5
RoE (pre-tax)	32.5%	33.9%	31.3%	33.6%	19.6%
Fidante Partners	42,502.5	35,879.4	33,670.8	29,757.0	23,984.3
Challenger Investment Partners	12,709.4	11,247.1	11,315.0	11,346.4	11,351.0
Closing FUM – total	**55,211.9**	**47,126.5**	**44,985.8**	**41,103.4**	**35,335.3**
Fidante Partners	40,493.9	34,850.7	31,550.2	27,359.9	21,250.9
Challenger Investment Partners	12,066.9	11,153.7	11,399.8	11,456.2	11,627.7
Average FUM – total[5]	**52,560.8**	**46,004.4**	**42,950.0**	**38,816.1**	**32,878.6**
FUM and net flows analysis					
Fidante Partners	5,426.1	1,148.1	1,263.6	4,801.9	2,742.8
Challenger Investment Partners	1,340.1	(114.5)	(149.8)	(47.5)	(518.6)
Net flows	6,766.2	1,033.6	1,113.8	4,754.4	2,224.2
Distributions	(164.5)	(105.9)	(129.0)	(245.4)	(70.0)
Market linked movement	1,483.7	1,213.0	2,897.6	1,259.1	2,164.0
Total FUM movement	**8,085.4**	**2,140.7**	**3,882.4**	**5,768.1**	**4,318.2**

1 Fidante Partners income includes distribution and administration fees.
2 Equity accounted profits represent Challenger's share of boutiques' pre-tax earnings.
3 Income margin represents net income divided by average FUM.
4 Net assets – average calculated on a monthly basis.
5 Average FUM calculated on a monthly basis.

Funds Management financial results

Challenger's Funds Management business is Australia's seventh[1] largest investment manager and one of Australia's fastest growing. Over three years Funds Under Management (FUM) has doubled, driven by a clear business strategy, which is focused on investor alignment.

Fidante Partners' multi boutique platform comprises separately branded, investment management businesses. The model aligns the interests of investors, boutique investment managers and Fidante Partners.

The Fidante Partners model is delivering superior investment performance, with 97% of all funds and mandates outperforming their benchmark since inception.

Challenger Investment Partners manage fixed income and property under Challenger's brand for the Life Company and third party institutional investors. During 1H15, Challenger Investment Partners infrastructure business was merged with Access Capital Advisers to form Whitehelm Capital and create Fidante Partners first infrastructure boutique.

EBIT and RoE

Funds Management 1H15 EBIT of $21m was unchanged from 1H14. Higher total net fee income (up $2m) was offset by higher expenses (up $2m).

1H15 Funds Management RoE was 32.5%, and has increased by 120 basis points from 1H14.

Total net fee income

1H15 total net fee income increased by $2m (4%) due to higher Fidante Partners net income (up $1m) and higher Challenger Investment Partners fee income (up $1m).

Fidante Partners net fee income includes distribution fees, administration fees and a share in the equity accounted profits of boutique investment managers. Fidante Partners net income also includes performance fees earned by boutiques.

1H15 Fidante Partners net income was $32m, which was up 3% ($1m) on 1H14. Higher net income resulted from higher average FUM, offset by a lower contribution from performance fees. 1H15 Fidante Partners net income includes $4m in relation to performance fees, down from $9m in 1H14.

Fidante Partners income margin (net income to average FUM) was 16 bps, down 4 bps on both 1H14 and 2H14. The reduction in net income margin is due to a lower contribution from performance fees.

1H15 performance fees were impacted by equity markets, which fell in 1H15. No performance fees on funds are earned in periods of negative investment performance, despite relative performance.

Challenger Investment Partners net income increased by $1m (6%) in 1H15, with higher performance and transaction fees (up $3m) partially offset by lower net management fees (down $2m). Net management fees fell as a result of a change in FUM mix, including the removal of Challenger Investment Partners infrastructure business following the formation of Whitehelm Capital and the consolidation of Challenger's ABS (Asset Backed Securities) fixed income team into Challenger Investment Partners.

Challenger Investment Partners 1H15 income margin (net income to average FUM) was 39 bps, which was down 1 bp from 1H14. The change in FUM mix from the removal of Challenger Investment Partners infrastructure business and inclusion of ABS fixed income team reduced the income margin by 5 bps, which was largely offset by higher performance and transaction fees (4 bps).

Expenses

1H15 total expenses were $35m, representing an increase of $2m (7%) on 1H14.

The increase in expenses is mainly due to higher personnel expenses (up $2m) from an increase in employee numbers following the transfer of the ABS fixed income team. The ABS fixed income team has been transferred to Funds Management to increase efficiencies and allow Funds Management to offer ABS product to third party clients.

The 1H15 cost to income ratio was 62.9%, which is up from 61.5% in 1H14 due to lower performance fees and higher expenses.

FUM

Total Funds Under Management (FUM) at 31 December 2014 was $55.2bn, up 23% for the 12 months.

Fidante Partners FUM and net flows

Fidante Partners 1H15 FUM was $42.5bn, up $8.8bn (26%) for the 12 months. FUM growth was driven by strong net flows and positive market movements.

Fidante Partners 1H15 net flows were $5.4bn, up from $1.3bn in 1H14. 1H15 net flows benefited from the formation of Whitehelm Capital ($3.9bn) and strong organic net flows across boutique managers ($1.5bn).

1 Consolidated FUM for Australian fund managers – Rainmaker Roundup September 2014.

On 1 July 2014 Whitehelm Capital was formed following the merger of Challenger Investment Partners infrastructure business with Access Capital Advisers, resulting in $3.9bn of infrastructure net flows. Whitehlem Capital is Fidante Partners first infrastructure boutique and manages approximately $4 billion of FUM focused on core infrastructure assets such as regulated utilities and airports.

Fidante Partners organic net flows were $1.5bn in 1H15 and were across a variety of managers. Organic net flows were driven by strong investment performance and Fidante Partners' extensive distribution capability.

Approximately 51% of Fidante Partners 1H15 FUM is invested in fixed income products, 39% in equity products and 10% in alternatives (e.g. infrastructure).

For additional Fidante Partners FUM and net flow commentary, refer to the Funds Under Management and net flow detail on page 27.

Challenger Investment Partners FUM and net flows

Challenger Investment Partners 1H15 FUM was $12.7bn, which was up $1.4bn (12%) for the 12 months. The increase in FUM was driven by net flows of $1.3bn, up from an outflow of $0.1bn in 1H14.

Challenger Investment Partners 1H15 net flows includes $0.9bn in relation to:

- Life's ABS fixed income team transferred to Challenger Investment Partners on 1 July 2014 resulting in a net inflow of $1.8bn; and
- the consolidation of Challenger Investment Partners infrastructure business with Access Capital Advisers to form Whitehelm Capital on 1 July 2014 resulting in a net outflow of $0.9bn.

Challenger Investment Partners 1H15 organic net flows were $0.5bn and include flows from Life in respect of property and fixed income mandates and fixed income mandate flows from third party clients. Challenger Investment Partners organic net flows include a $0.2bn outflow associated with the closure of the Howard Mortgage Fund.

Approximately 68% of Challenger Investment Partners 1H15 FUM is invested in fixed income and approximately 32% of FUM is invested in property.

For additional Challenger Investment Partners FUM and net flow commentary, refer to the Funds Under Management and net flow detail on page 27.

Outlook

The Australian funds management market remains an attractive market underpinned by mandated superannuation contributions. Contributions increased to 9.5% of gross salaries on 1 July 2014 and are scheduled to increase to 12% by 2022. The mandated nature of Australia's superannuation system is expected to significantly grow the size of Australia's superannuation assets from $1.9 trillion[1] at 30 September 2014, to over $7 trillion[2] in the next 20 years.

Fidante Partners continues to identify new investment manager talent. The platform has a variety of managers across Australian equities, international equities, fixed income and infrastructure. Fidante Partners is adding capacity to existing managers and has significant capacity to increase FUM, which is expected to generate future earnings growth.

Challenger Investment Partners continues to build out its client base and product offering. Challenger Investment Partners remains focused on growing its third party fiduciary business, and there are opportunities to add new mandates from domestic and international institutions, superannuation funds and sovereign wealth funds.

Challenger's Funds Management business is well positioned to benefit from growth in Australia's superannuation system. The Funds Management platform has multiple brands and strategies with significant manager capacity. Coupled with Challenger's distribution capability, institutional strength administration platform and strong boutique investment manager performance, the Funds Management business is well positioned to continue to increase shareholder returns.

1 APRA Superannuation Statistics – September 2014.
2 Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2013 – 2033 – September 2013.

Corporate financial results

$m	1H15	2H14	1H14	2H13	1H13
Other income	**0.7**	**0.6**	**1.2**	**1.7**	**3.2**
Personnel expenses	(18.3)	(17.7)	(16.6)	(17.0)	(17.6)
Other expenses	(4.6)	(5.6)	(4.8)	(5.4)	(5.3)
Total expenses (excluding LTI)	**(22.9)**	**(23.3)**	**(21.4)**	**(22.4)**	**(22.9)**
Long term incentives (LTI)[1]	(8.0)	(8.4)	(8.3)	(5.3)	(5.5)
Total expenses	**(30.9)**	**(31.7)**	**(29.7)**	**(27.7)**	**(28.4)**
Normalised EBIT	**(30.2)**	**(31.1)**	**(28.5)**	**(26.0)**	**(25.2)**
Interest and borrowing costs	(1.7)	(1.9)	(2.2)	(1.9)	(2.7)
Normalised profit/(loss) before tax	**(31.9)**	**(33.0)**	**(30.7)**	**(27.9)**	**(27.9)**

Corporate financial results

The Corporate division comprises central functions such as group executives, finance, treasury, legal, human resources, risk management and strategy.

Corporate also includes interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

Normalised profit/(loss) before tax

1H15 Corporate normalised profit before tax was a loss of $32m, up from a loss of $31m in 1H14. The increase in Corporate normalised loss was due to lower EBIT (down $2m), partly offset by lower interest and borrowing costs (down $1m). Corporate EBIT fell $2m due to lower net income (down $1m) and higher expenses (up $1m).

Net income

Net income includes interest received on Group cash balances. 1H15 net income decreased by $1m from 1H14 as a result of a lower average cash balance on which interest income is earned.

Total expenses

1H15 total expenses were $31m, up $1m on 1H14. The increase in expenses is due to higher personnel costs as a result of higher employee numbers.

Long term incentive costs were $8m in 1H15, down 4% on 1H14 and relate to the non-cash amortisation of equity grants.

Interest and borrowing costs

1H15 interest and borrowing costs were $2m, down $1m on 1H14 and relate to Challenger's debt facility. The debt facility was undrawn during 1H15 with interest and borrowing costs reflecting debt facility fees. The Group maintains a banking facility to provide additional financial flexibility.

1 Corporate financial results include all of the Group's long term incentives provided under the Challenger Performance Plan and Long Term Incentive Plan. Short term incentives under the Employee Incentive Plan are accounted for within each operating division's personnel expenses.

Consolidated operating cash flows

$m	1H15	2H14	1H14	2H13	1H13
Receipts from customers	254.2	259.5	249.0	224.9	231.9
Dividends received	34.0	34.3	26.9	22.5	21.7
Interest received	269.6	279.1	270.2	272.8	269.9
Interest paid	(213.4)	(203.1)	(203.4)	(187.5)	(185.8)
Payments to suppliers and employees	(207.1)	(180.2)	(197.1)	(159.0)	(185.2)
Income tax paid	(43.7)	(12.0)	(2.2)	(3.3)	(1.4)
Underlying operating cash flow	**93.6**	**177.6**	**143.4**	**170.4**	**151.1**
Adjust for:					
Net retail annuity policy capital receipts	560.8	63.5	539.9	385.3	212.8
Net institutional capital (payments)/ receipts	(170.0)	25.3	(770.4)	(40.0)	(110.0)
Other[1]	(15.8)	(5.5)	(26.4)	12.5	7.1
Operating cash flow per financial report	**468.6**	**260.9**	**(113.5)**	**528.2**	**261.0**

Consolidated operating cash flows

Underlying operating cash flow excludes cash flows that are capital in nature such as annuity sales and annuity capital payments.

1H15 underlying operating cash flow was $94m, down from $143m in 1H14. The reduction was primarily due to higher tax payments and lower interest receipts in 1H15. The income tax paid in 1H15 was $44m compared to $2m in 1H14 and reflects the Group's monthly tax instalments as well as the final FY14 tax instalment paid in this period. Challenger was not subject to monthly tax instalments in 1H14. 1H15 interest received is lower than 2H14 due to a timing difference, with interest to be collected in 2H15.

Net retail annuity policy capital receipts

Net retail annuity policy capital receipts in 1H15 were $561m and comprise:

- retail annuity sales of $1,575m; less
- retail annuity capital payments of $1,014m.

Retail annuity capital payments are capital payments to annuitants and exclude interest payments.

Retail annuity net book growth can be calculated as retail annuity net flows ($561m) divided by opening period Life retail annuity book ($7,824m for FY14 – refer to page 6). 1H15 retail annuity net book growth was 7.2%.

Retail annuity net book growth

In November 2014 Challenger announced it would discontinue the Care Annuity product in its current form as a result of the Department of Social Services redefining how the Care Annuity would be treated for social security purposes. A replacement Care Annuity product is in development and Challenger expects to re-enter the aged care market. Excluding Care Annuity, 1H15 net book growth was 6.3%.

At the time of the DSS announcement in November 2014 (refer to page 17 for more detail) Challenger withdrew its FY15 net book growth guidance (12% to 14%) until further details on the Care Annuity could be provided to the market. The FY15 retail annuity net book is now expected to grow by between 11% (~$850m) and 13% (~$1,000m), with the original growth target reduced by 1% (from the initial guidance 12% to 14%). The growth target of between 11% and 13% is not dependent on a replacement Care Annuity product being launched in 2H15.

Net institutional capital payments

1H15 net institutional capital payments of $170m comprise:

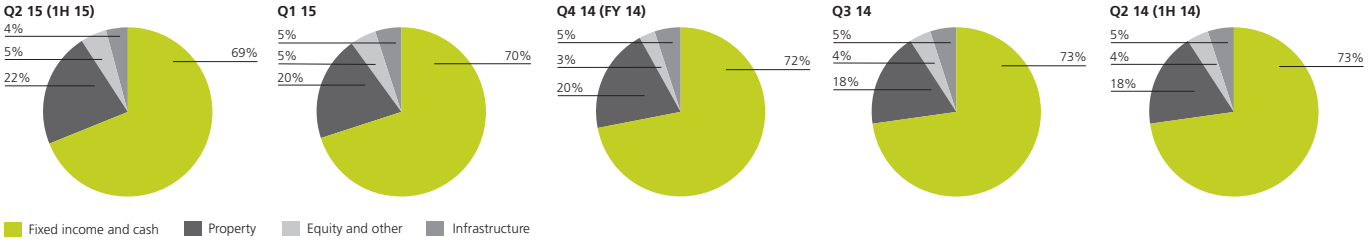
- Institutional capital payments $719m; less
- Institutional sales of $549m.

1 Other includes net SPV operating cash flow and adjustments for classification differences between statutory operating cash flow and normalised cash operating earnings.

Assets and Funds Under Management, net flows and sales

$m	Q2 15	Q1 15	Q4 14	Q3 14	Q2 14
Total Assets and Funds Under Management	**57,169**	**54,189**	**50,725**	**49,502**	**48,814**
Represented by:					
Funds Management					
Fidante Partners[1]					
Equities	16,626	15,960	16,541	16,570	16,384
Fixed income	21,795	20,699	19,338	18,104	17,287
Alternatives	4,082	3,893	–	–	–
Total Fidante Partners	42,503	40,552	35,879	34,674	33,671
Challenger Investment Partners[2]					
Fixed income	8,624	8,461	6,036	6,057	6,358
Infrastructure	–	–	922	896	912
Property					
Institutional mandates	4,085	3,565	3,418	3,160	3,157
Challenger Diversified Property Group (ASX:CDI) (gross assets)	–	–	871	888	888
Total Challenger Investment Partners	12,709	12,026	11,247	11,001	11,315
Total funds under management	**55,212**	**52,578**	**47,126**	**45,675**	**44,986**
Average Fidante Partners	41,567	39,435	35,634	34,024	32,306
Average Challenger Investment Partners	12,339	11,784	11,066	11,203	11,449
Average total funds under management[3]	**53,906**	**51,219**	**46,700**	**45,227**	**43,755**
Life					
Fixed income and cash[4]	8,541	8,120	7,955	7,746	7,983
Property[4]	2,717	2,320	2,168	1,955	1,952
Equity and other	632	551	401	431	433
Infrastructure[4]	503	536	563	518	521
Total Life investment assets	**12,393**	**11,527**	**11,087**	**10,650**	**10,889**
Average Life investment assets[3]	**12,001**	**11,254**	**10,872**	**10,939**	**10,655**

Life asset allocation



1 Fidante Partners comprise a number of co-owned, separately branded active boutique investment managers from which Fidante receives distribution and administration fees. Fidante Partners also shares in the profits from these businesses through its equity ownership.
2 Challenger Investment Partners develops and manages products for the Life business and third party institutional investors.
3 Average total funds under management and Life investments calculated on a monthly basis.
4 Fixed income, property and infrastructure reported net of debt.

Assets and Funds Under Management, net flows and sales (continued)

Analysis of flows	Q2 15	Q1 15	Q4 14	Q3 14	Q2 14
Funds Management net flows					
Equities	220	(551)	(210)	(46)	76
Fixed Income	653	1,251	841	562	1,556
Alternatives	4	3,849	–	–	–
Total Fidante Partners	**877**	**4,549**	**631**	**516**	**1,632**
Challenger Investment Partners	609	731	149	(262)	(325)
Net flows	**1,486**	**5,280**	**780**	**254**	**1,307**
Life sales					
Fixed Term	727	529	664	335	592
Lifetime	158	161	200	143	151
Total Retail	**885**	**690**	**864**	**478**	**743**
Institutional	451	98	273	18	273
Sales	**1,336**	**788**	**1,137**	**496**	**1,016**
Reconciliation of Total Group Assets and Funds Under Management					
Funds Management (FUM)	55,212	52,578	47,126	45,675	44,986
Life investment assets	12,393	11,527	11,087	10,650	10,889
Adjustments to remove double counting of cross holdings:					
Life Company investment in CDI	–	–	(585)	(342)	(341)
Life Company investment in fixed income, property and infrastructure	(10,436)	(9,916)	(6,903)	(6,481)	(6,720)
Total Assets and Funds Under Management	**57,169**	**54,189**	**50,725**	**49,502**	**48,814**

Total Assets and Funds Under Management

1H15 total Assets and Funds Under Management was $57.2bn, up 17% (or $8.4bn) on 1H14.

Funds Management FUM and net flows

1H15 Funds Management FUM was $55.2bn, up 23% on 1H14.

Funds Management 1H15 net flows were $6.7bn with Fidante Partners achieving net flows of $5.4bn and Challenger Investment Partners net flows of $1.3bn.

Fidante Partners

Fidante Partners net flows are supported by strong investment performance across its boutique investment managers. Since inception of each boutique, 97% of all funds and mandates have outperformed their benchmark. Over three years, 93% of funds and mandates have outperformed their benchmarks. Over 1 year, 69% of funds and mandates have outperformed their benchmarks.

Fidante Partners 1H15 net flows were $5.4bn, up from $1.3bn in 1H14. 1H15 net flows include $3.9bn following the formation of Whitehelm Capital on 1 July 2014. Whitehelm Capital was formed by merging Access Capital Advisers and Challenger Investment Partners infrastructure businesses.

Fidante Partners 1H15 organic net flows were $1.5bn and include net flows of $1.9bn in relation to fixed income products and net outflows of $0.3bn in relation to equity products. 1H15 equity product net flows were impacted by first quarter outflows, with equity products achieving net inflows of $0.2bn in the second quarter. All fixed income boutiques achieved positive net flows in 1H15.

At 31 December 2014, approximately 51% of Fidante Partners FUM was invested in fixed income products, 39% in equity products and 10% in infrastructure products.

Challenger Investment Partners

Challenger Investment Partners achieved net flows of $1.3bn in 1H15, and includes:

- inflow of $1.8bn on 1 July 2014 in relation to the transfer of Life's ABS fixed income team;
- outflow of $0.9bn on 1 July 2014 in relation to Challenger Investment Partners infrastructure business transferred to Whitehelm Capital;
- outflow of $0.2bn in relation to the return of capital to Howard Mortgage Fund investors following closure of the fund; and
- inflow of $0.6bn in relation to expansion of property and fixed income mandates from both Life and third party clients.

Life AUM and sales

1H15 Life AUM was $12.4bn, up 14% on 1H14.

1H15 Life retail annuity sales were $1.6bn, representing an 8% increase on 1H14 and were a record half yearly retail annuity sales result. Lifetime annuity (i.e. Liquid Lifetime and Care Annuity) sales represented 20% of total 1H15 retail annuity sales, increasing from only 10% two years ago (1H13).

Care Annuity sales in 1H15 were $100m, which was down from $127m in 1H14. Care Annuity product sales were suspended in late November 2014 following the Department of Social Services decision to redefine how the Care Annuity would be treated for social security purposes. Existing Care Annuity customers are not impacted and in order to reduce future uncertainty, Challenger discontinued the Care Annuity product in its current form. Challenger is currently working on a replacement Care Annuity product.

Retail annuity sales continue to benefit from strong reinvestment rates for term annuities with residual capital value. Term annuity reinvestments in 1H15 were $321m, or 20% of total retail annuity sales.

1H15 average tenor for new business sales was 6.6 years, up from 6.4 years in 1H14. Tenor is lengthening as a result of increasing demand for longer dated products, including lifetime annuity products. A lengthening of tenor assists future net book growth, enables investment in longer-dated assets, which earn higher illiquidity premiums, and is more efficient in terms of distribution and administration.

1H15 institutional sales were $549m, mainly representing the reinvestment of maturities in Challenger's Guaranteed Index Return (GIR) product with GIR maturities invested for a longer tenor.

Profit and equity sensitivities

$m	Change in variable	Profit/(loss) after tax 1H15	Change in equity 1H15	Profit/(loss) after tax FY14	Change in equity FY14	Profit/(loss) after tax FY13	Change in equity FY13
Interest rate							
Non-SPV	+100bps	4.1	4.1	5.0	5.0	5.5	5.5
	–100bps	(4.1)	(4.1)	(5.0)	(5.0)	(5.5)	(5.5)
SPV	+100bps	(2.3)	(2.3)	(2.6)	(2.6)	(3.6)	(3.6)
	–100bps	2.3	2.3	2.6	2.6	3.6	3.6
Total	+100bps	1.8	1.8	2.4	2.4	1.9	1.9
	–100bps	(1.8)	(1.8)	(2.4)	(2.4)	(1.9)	(1.9)
Infrastructure and equity							
Infrastructure investments	+10%	19.4	19.4	25.2	25.2	21.2	21.2
	–10%	(19.4)	(19.4)	(25.2)	(25.2)	(21.2)	(21.2)
Equity investments	+10%	36.4	36.4	20.6	20.6	16.1	16.1
	–10%	(36.4)	(36.4)	(20.6)	(20.6)	(16.1)	(16.1)
Total	+10%	55.8	55.8	45.8	45.8	37.3	37.3
	–10%	(55.8)	(55.8)	(45.8)	(45.8)	(37.3)	(37.3)
Property							
Direct Property	+1%	19.7	19.7	16.5	16.5	13.3	13.3
	–1%	(19.7)	(19.7)	(16.5)	(16.5)	(13.3)	(13.3)
Australian listed property securities	+10%	14.0	14.0	11.1	11.1	10.3	10.3
	–10%	(14.0)	(14.0)	(11.1)	(11.1)	(10.3)	(10.3)
Other property securities	+10%	18.1	18.1	21.8	21.8	21.1	21.1
	–10%	(18.1)	(18.1)	(21.8)	(21.8)	(21.1)	(21.1)
Credit							
Fixed Income assets	+50bps	(80.8)	(80.8)	(78.9)	(78.9)	(91.9)	(91.9)
	–50bps	80.8	80.8	78.9	78.9	91.9	91.9
Currency							
British Pound	+10%	(0.1)	(0.1)	0.7	0.7	(1.0)	(1.0)
	–10%	0.1	0.1	(0.7)	(0.7)	1.0	1.0
US Dollar	+10%	0.3	0.3	(0.1)	(0.1)	(0.2)	(0.2)
	–10%	(0.3)	(0.3)	0.1	0.1	0.2	0.2
Euro	+10%	0.4	0.4	(0.4)	(0.4)	(2.0)	(2.0)
	–10%	(0.4)	(0.4)	0.4	0.4	2.0	2.0
Japanese Yen	+10%	0.1	0.1	–	–	–	–
	–10%	(0.1)	(0.1)	–	–	–	–
Other	+10%	0.1	0.1	1.7	1.7	–	–
	–10%	(0.1)	(0.1)	(1.7)	(1.7)	–	–
Mortality[1]							
Life insurance contract liabilities	+50%	(42.4)	(42.4)	(25.6)	(25.6)	(13.7)	(13.7)
	–50%	42.4	42.4	25.6	25.6	13.7	13.7

1 Mortality life insurance contract liabilities sensitivity is net of any reinsurance with third parties.

Profit and equity sensitivities

Profit and equity sensitivities set out the expected impact from changes in a range of economic and investment market variables on Challenger's earnings. These sensitivities represent the after-tax impact, assuming a tax rate of 30%.

The sensitivities are not forward looking and make no allowance for events occurring after 31 December 2014. If using these sensitivities as forward looking, an allowance for changes post 31 December 2014, such as sales and asset growth, should be made.

These sensitivities assess the risk of changes in economic and investment markets on the valuation of assets, which in turn impact earnings. The earnings impact is included in investment experience and does not take into consideration the impact of any under or over performance of normalised growth assumptions for each asset category. Refer to page 33 for normalised growth assumptions.

These sensitivities do not include the indirect impact on fees for the Funds Management business.

Interest rate sensitivities

Interest rate risk is the risk to earnings from movements in interest rates, including changes in absolute levels, shape of the yield curve, margin between different yield curves, and volatility of interest rates.

It is assumed that the change in variable occurs on 31 December 2014, and is based on assets and liabilities held at that date. It is the Group's policy to minimise the impact of movements in interest rates via the use of interest rate swaps. Interest rate sensitivities are disclosed as either SPV (special purpose vehicle) or non-SPV.

SPV interest rate sensitivities relate to securitisation trusts that hold residual income stream notes (NIM) acquired by Challenger Life Company in FY09. For the SPV, changes in the BBSW benchmark over the RBA's target cash rate, results in a change in the cost of funding and impacts earnings. SPV interest rate risk is mitigated through the use of hedges.

In determining the interest rate sensitivities, it is assumed that changes in interest rates occur at balance date and there are concurrent movements in interest rates and parallel moves in the yield curve. All material underlying exposures and related interest rate hedges are included in the interest rate sensitivities.

Infrastructure and equity sensitivities

The equity sensitivities apply to Challenger's financial assets, as disclosed in Note 8 of Challenger's 31 December 2014 interim financial report.

Infrastructure and equity risk sensitivities represent the impact of changes in investment markets on asset valuations on balance date.

Property sensitivities

Direct property sensitivities relate to Challenger's direct property portfolio.

The direct property sensitivities represent the impact from a change in property valuations on balance date and are based on Life's gross direct property investments of $3,396m (net investments of $2,717m plus debt of $679m). They do not include the impact on management fees in Funds Management.

The property securities sensitivities relate to listed and unlisted property securities, such as real estate investment trusts.

Property sensitivities do not include the impact of property acquisition costs (e.g. stamp duty). Under Australian accounting standards, property acquisition and transaction costs are required to be capitalised. When the property is subsequently revalued, there is generally no value ascribed to the acquisition costs which may result in a reduction in the property value and a corresponding negative investment experience impact.

Credit sensitivities

Credit risk sensitivities set out the expected impact from movements in credit spreads. Challenger is exposed to movements in credit spreads above the interbank swap curve on its fixed income portfolio. The sensitivities apply to fixed income investments held at 31 December 2014.

Currency sensitivities

Currency sensitivities set out the expected impact from changes in currency. It is the Group's policy to hedge the exposure of all balance sheet items for movements in foreign exchange rates. Currency exposure arises primarily as a result of offshore investments. In order to mitigate foreign currency risk, the Group has entered into foreign currency derivatives.

Mortality sensitivities

Challenger is exposed to longevity risk on its life insurance liabilities and wholesale longevity reinsurance transactions. Longevity risk is the risk that annuitants may live longer than expected. Mortality risk is the risk that mortality on the underlying portfolio exceeds expectations. There is a natural hedge between longevity and mortality risk. CLC is required under APRA prudential standards to maintain regulatory capital in relation to the longevity and mortality risk it carries.

Challenger manages some of its longevity risk exposure by using reinsurance for the closed lifetime annuity portfolios (e.g. AXA) as well as regularly reviewing the portfolio and longevity experience to ensure longevity assumptions remain appropriate. Mortality risk is managed by regularly reviewing the portfolio and mortality experience.

Mortality rates are based on industry standards which are adjusted for Challenger's own recent experience, along with expected future rates of mortality improvement.

Challenger assumes that future mortality rates for individual lifetime annuities will improve by between 1% and 4% per annum (depending on different age cohorts). This has the impact of increasing the life expectancy of a male aged 65 from 21 years (per the base mortality rates) to 27 years.

The mortality sensitivities set out the expected impact of an improvement in mortality. This is in addition to the mortality improvements Challenger already assumes. A 50% increase in mortality improvement rates would increase the life expectancy of a male aged 65 from 27 years (above) to 32 years.

Issued share capital

Number of shares (m)	1H15	2H14	1H14	2H13	1H13
Basic share count	552.9	510.6	514.1	515.6	526.4
CPP 'treasury' shares	16.8	20.3	16.8	15.3	12.3
Total issued shares	**569.7**	**530.9**	**530.9**	**530.9**	**538.7**
Movement in basic share count					
Opening	510.6	514.1	515.6	526.4	529.0
CPP deferred share purchase	(4.6)	–	(3.0)	(3.0)	(3.6)
Net treasury shares (acquired)/released	8.1	(3.5)	1.5	–	7.0
On market buyback during the period	–	–	–	(7.8)	(6.0)
New share issues	38.8	–	–	–	_
Closing	552.9	510.6	514.1	515.6	526.4
Movement in CPP 'treasury' shares					
Opening	20.3	16.8	15.3	12.3	15.7
Shares vested to participants	(13.6)	(0.4)	(3.3)	–	(7.0)
CPP deferred share purchase	4.6	–	3.0	3.0	3.6
Shares bought into CPP Trust	5.5	3.9	1.8	–	–
Closing	16.8	20.3	16.8	15.3	12.3

Share capital for EPS calculations Weighted average number of shares (m)	1H15	2H14	1H14	2H13	1H13
Basic EPS shares					
Total issued shares	556.0	530.9	530.9	533.5	544.0
Less CPP 'treasury' shares	(17.8)	(17.8)	(16.4)	(12.7)	(12.6)
Shares for basic EPS calculation	538.2	513.1	514.5	520.8	531.4
Diluted EPS shares					
Shares for basic EPS calculation	538.2	513.1	514.5	520.8	531.4
Add dilutive impact of equity awards schemes	23.0	30.4	25.8	8.6	3.6
Add dilutive impact of capital notes	25.4	–	–	–	–
Shares for dilutive EPS calculation	586.6	543.5	540.3	529.4	535.0

Summary of Share Rights and Options Number (m)	1H15	2H14	1H14	2H13	1H13
Hurdled Performance Share Rights					
Opening	26.6	27.0	21.8	22.2	14.4
New grants	2.4	–	6.6	0.2	8.2
Vesting/forfeiture	(11.4)	(0.4)	(1.4)	(0.6)	(0.4)
Closing	17.6	26.6	27.0	21.8	22.2
Performance Share Rights					
Opening	3.8	3.8	3.3	3.3	3.2
New grants	2.3	–	2.5	0.1	2.6
Vesting/forfeiture	(2.5)	–	(2.0)	(0.1)	(2.5)
Closing	3.6	3.8	3.8	3.3	3.3

Issued share capital and diluted share count

The number of Challenger Limited shares listed on the Australian Securities Exchange (ASX) at 31 December 2014 was 570m shares, up from 531m shares at 30 June 2014. The increase in shares listed on the ASX reflects:

- $250m institutional equity placement undertaken in August 2014 with 33.2m shares issued; and
- $40m Share Purchase Plan (SPP) for retail investors completed in October 2014 with 5.7m shares issued.

Refer to page 11 for additional detail on 1H15 capital management initiatives completed.

The basic and diluted share counts used to determine Challenger's normalised and statutory EPS is based on requirements set out in Australian accounting standards. Under Australian accounting standards:

- the basic share count is reduced for treasury shares;
- the dilutive share count includes unvested equity awards made to employees under the Challenger Performance Plan Trust; and
- the dilutive share count considers convertible instruments (e.g. Challenger Capital Notes), with inclusion in the dilutive share count determined by a probability of vesting test.

Treasury shares

The Challenger Performance Plan (CPP) Trust was established to satisfy Challenger's employee equity obligations arising from hurdled and non-hurdled equity awards issued under employee remuneration structures. Shares are acquired by the CPP Trust to mitigate shareholder dilution and to provide a mechanism to hedge the cash cost of acquiring shares in the future to satisfy vested equity awards.

The CPP Trust typically acquires physical shares on market or via forward share purchase agreements entered into by Challenger. The use of forward share purchase agreements was implemented in FY13 to support increased capital efficiency. Shares held by the CPP Trust are classified as treasury shares.

It is expected that should equity awards vest in future periods, the CPP Trust will satisfy equity requirements via a combination of treasury shares and settlement of forward purchase agreements. As such, it is not currently anticipated that additional Challenger shares will be issued to meet future vesting obligations of equity awards.

Unvested equity awards

Hurdled Performance Share Rights (HPSRs)

Challenger's approach to executive remuneration includes providing LTI awards to ensure alignment between key employees and shareholders. LTI awards are delivered as Hurdled Performance Share Rights (HPSRs), which vest over a five year period and are subject to meeting TSR performance hurdles before vesting.

Deferred Performance Share Rights (DPSRs)

A portion of Short Term Incentive (STI) awards are deferred and vest over a three year period. The deferred STI is delivered as Deferred Performance Share Rights (DPSRs) and vesting is subject to continued employment.

Challenger Capital Notes

In October 2014 Challenger issued $345m worth of Challenger Capital Notes, which are subordinated, unsecured convertible notes issued by Challenger Limited (refer to page 11 for more detail).

Under Australian accounting standards convertible debt is considered dilutive whenever the interest per ordinary share obtainable on conversion is less than the basic earnings per share. As such, for Challenger Capital Notes a test is required to be undertaken each reporting period to determine if the notes are included in the dilutive share count.

At 31 December 2014, Challenger Capital Notes have been considered under Australian accounting standards to be dilutive and have been included in Challenger's 1H15 dilutive share count.

Challenger Capital Notes are convertible to ordinary shares at any time before May 2022 on the occurrence of certain events, and mandatorily convertible to ordinary shares thereafter, in both cases subject to certain conditions being met. However Challenger also retains the option to redeem or resell Challenger Capital Notes on the occurrence of certain events, as well as an outright option to redeem or resell on 25 May 2020 (also both subject to certain conditions being met). If Challenger exercises its option to redeem or resell, then there will be no conversion of Challenger Capital Notes to ordinary shares and subsequent dilution to existing Challenger ordinary shareholders.

External options

There were no external options outstanding over Challenger Limited shares at 31 December 2014.

Normalised profit framework

Life normalised cash operating earnings

Normalised cash operating earnings is Challenger's preferred profitability measure for the Life business, as it aims to reflect the underlying performance trends of the Life business.

The Life normalised cash operating earnings framework was introduced in June 2008 and has been applied consistently since. The framework removes the impact of market and economic variables, which are generally non-cash and are a result of external market factors. The normalised profit framework is subject to a review performed by Ernst & Young each half year.

Life normalised cash operating earnings includes cash earnings plus normalised capital growth, but excludes investment experience (refer below).

Cash earnings	Cash earnings represents investment yield (policyholder), less interest expenses (both annuitant funding costs and interest costs on subordinated debt and Challenger Capital Notes) and fees and commissions paid. **Investment yield – policyholders' funds** Represents the investment return on assets held to match annuities. Investment yield includes net rental income, dividends received, infrastructure distributions, accrued interest on fixed income and cash, and discounts/premiums on fixed income assets amortised on a straight line basis. **Interest expense** Represents interest accrued at contracted rates to annuitants, and interest paid and accrued on Life subordinated debt and Challenger Capital Notes. **Fees and commissions** Represents payments made for the acquisition and management of Life products, including annuities and commissions to third party mortgage brokers on term funded residential mortgage assets (NIM). **Other income** Other income includes revenue from Accurium (previously Bendzulla Actuarial) and profits on wholesale longevity and mortality transactions (refer to page 18).
Normalised capital growth	Normalised capital growth represents the expected capital growth for each asset class through the investment cycle and is based on Challenger's long term expected investment returns for each asset class. Normalised capital growth can be determined by multiplying the normalised capital growth assumption (refer below) by average asset balance (net of debt) for the period. Normalised capital growth assumptions: • Fixed income and cash – negative 0.35% representing an allowance for credit defaults; • Property – 2.00%; • Equity and alternative asset classes – 6.00%; and • Infrastructure – 4.00. Normalised capital growth assumptions have been set with reference to long term market growth rates and are reviewed regularly to ensure consistency with prevailing medium to long term market conditions. Since the normalised profit framework was introduced in 2008, the only change to the normalised capital growth assumptions has been a reduction in property from 2.50% to 2.00% in FY10. The reduction in the property assumption reflected the purchase of a portfolio of Japanese properties, which have lower expected long term capital growth returns.

Normalised profit framework

Investment experience	Challenger Life is required by Australian accounting standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss, particularly during periods of market volatility. As Challenger is generally a long-term holder of assets, due to them being held to match the term of life liabilities, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation movements from Life business earnings so as to more accurately reflect the underlying performance of the Life business. The asset and liability valuation movements are reported as investment experience. These movements are generally non-cash, and by separating them from the Life business result, Life's reported earnings more closely represent the cash earnings of the Life business. **Impact from economic variables** Investment experience also includes the impact of changes in macroeconomic variables on the valuation of Life's assets and liabilities. Economic and actuarial assumption changes include changes to bond yields and inflation factors, expense assumptions, accounting losses on writing new business net of the unwind of prior period losses and other factors applied in the valuation of life contract liabilities. Investment experience is calculated as the difference between actual investment gains/losses (both realised and unrealised) and the normalised capital growth plus any economic and actuarial assumption changes for the period.

Glossary of terms

Terms	Definitions
Additional Tier 1 regulatory capital	High quality capital that provides a permanent and unrestricted commitment and is freely available to absorb losses.
Cash earnings (Life)	Investment yield and other income less interest expenses and fees and commissions paid.
CET1 ratio	Common Equity Tier 1 regulatory capital divided by Prescribed Capital Amount.
Common Equity Tier 1 regulatory capital	The highest quality capital comprising items such as paid-up ordinary shares and retained earnings. Common Equity Tier 1 capital is subject to certain regulatory adjustments including in respect of intangibles and adjusting policy liabilities.
Earnings per share	Net profit after tax divided by weighted average number of shares in the period.
Equity accounted profits (FM)	Challenger's share of Fidante Partners boutique investment manager pre-tax profits.
Fees and commissions paid (Life)	Payments made for the acquisition and management of annuities and other Life products.
Fidante Partners income (FM)	Distribution and administration fees from boutique investment managers.
Funds under management (FUM)	Total value of unlisted funds/mandates managed by the Funds Management business.
Group cash	Cash available to Group excluding cash held by Challenger Life Company.
Interest and borrowing costs (Corporate)	Interest and borrowing costs associated with group debt and group debt facilities.
Interest expenses (Life)	Interest accrued and paid to annuitants, subordinated debt note and Challenger Capital Note holders and other debt providers.
Investment experience (Life)	The difference between actual investment gains/losses (both unrealised and realised) and the normalised capital growth plus any economic and actuarial assumption changes for the period.
Investment yield (Life)	Net rental income, dividends received and accrued interest and discounts/premiums on fixed income securities amortised on a straight line basis.
Investment yield – shareholder funds (Life)	Represents the return on shareholder capital held by the Life business.
Life investment assets	Total value of investment assets that are managed by the Life business.
Life net book growth	Life net retail annuity policy capital receipts over the period divided by the opening Life retail annuity book.
Life net retail annuity policy receipts	Life retail annuity sales less retail annuity capital payments.
Net assets – average (Group)	Average net assets over the period (excluding non-controlling interest) calculated on a monthly basis.
Net fee income (FM)	Fidante Partners income, equity accounted profits (FM) and Challenger Investment Partners net management fees and performance and transaction fees.
Net management fees (FM)	Management fees for managing investments.
Net tangible assets	Consolidated net assets less goodwill and intangibles.
Net Interest Margin (NIM)	Net interest margin on term funded prime mortgages and included as part of Life's investment assets.
Normalised capital growth	Long term expected capital growth based on long term return assumptions calculated as long term capital growth assumption multiplied by average investment assets.
Normalised Cash Operating Earnings (NCOE) (Life)	Cash earnings plus normalised capital growth.

Glossary of terms

Terms	Definitions
Normalised cost to income ratio	Total expenses divided by total net income.
Normalised dividend payout ratio	Dividend per share divided by normalised earnings per share (basic).
Normalised EBIT (Life)	Normalised cash operating earnings less total Life expenses.
Normalised EBIT (FM)	Net income less total FM expenses.
Normalised effective tax rate	Normalised tax divided by normalised profit before tax.
Normalised Return on Equity (RoE) – pre-tax	Normalised Life EBIT, FM EBIT or Normalised NPBT (Group) divided by average net assets.
Normalised Return on Equity (RoE) – post-tax	Group's normalised NPAT divided by average net assets.
Other expenses	Non-employee expenses, including external professional services, occupancy costs, marketing and advertising, travel, technology and communications costs.
Other income (Corporate)	Includes equity accounted profits of associates and interest received on Group cash balances.
Other income (Life)	Relates to Accurium (previously Bendzulla Actuarial) revenue and wholesale longevity and mortality transactions. Refer to page 18 for more detail.
Performance and transaction fees (FM)	Fees earned for outperforming benchmarks and fees earned for the origination, disposal and restructuring of assets.
Personnel expenses	Includes fixed and short term variable incentive components of remuneration structures. The amortisation of long term incentive plans is reported separately within the Corporate results.
PCA ratio	CLC total regulatory capital divided by CLC Prescribed Capital Amount.
Prescribed Capital Amount (PCA)	Amount of capital that a life company must hold which is intended to be sufficient to withstand a 1 in 200 year shock and still meet adjusted policy liabilities and other liabilities. For further details refer to APRA's LPS110 Capital Adequacy.
Product cash margin (Life)	Represents the return on assets backing annuities and other income, less interest expenses and fees and commissions paid.
Significant items	Non-recurring or abnormal income or expense items.
Statutory Return on Equity (RoE) – post tax	Statutory NPAT divided by average net assets.
Tier 1 ratio	CLC common equity tier 1 plus CLC additional tier 1 equity divided by prescribed capital amount.
Tier 1 regulatory capital	Tier 1 regulatory capital comprises common equity tier 1 regulatory capital and additional tier 1 regulatory capital.
Tier 2 regulatory capital	Tier 2 regulatory capital is capital that contributes to the overall strength of a life company and its capacity to absorb losses but does not satisfy all the criteria to be included as Tier 1 regulatory capital.
Total expenses	Personnel expenses plus other expenses.
Total net income	Normalised Cash Operating Earnings (Life) plus net fee income (FM) plus other income (Corporate).

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