



Challenger Limited ACN 106 842 371

# Analyst Pack **FY16**

**30 June 2016**

**Challenger Limited** – providing  
our customers with financial  
security for retirement.

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|-----------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|

## Important Note

Information presented in the Analyst Pack FY16 is presented on an operational basis (rather than statutory) to reflect a management view of the business. Challenger Limited (ACN 106 842 371) also provides statutory reporting as prescribed under the Corporations Act 2001. The audited full year financial report is available from Challenger's website at [www.challenger.com.au](http://www.challenger.com.au).

The analyst pack is not audited. The statutory net profit after-tax as disclosed in the consolidated profit and loss (page 2) has been prepared in accordance with Australian Accounting Standards and the Corporations Act 2001. Challenger's external auditors, Ernst & Young, have audited the statutory net profit after-tax as disclosed in the consolidated profit and loss. Normalised profit after-tax, as disclosed in the consolidated profit and loss (see page 2) has been prepared in accordance with a normalised profit framework. The normalised profit framework has been disclosed in section 4.2 of the Directors' Report in the Challenger Limited Annual Report 2016. 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.

Past performance is not an indicator of future performance. 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.

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## Key performance indicators

|                                                           | FY16      | FY15    | FY14    | 2H16     | 1H16      | 2H15    | 1H15    | 2H14    | 1H14    |
|-----------------------------------------------------------|-----------|---------|---------|----------|-----------|---------|---------|---------|---------|
| <b>Earnings</b>                                           |           |         |         |          |           |         |         |         |         |
| Normalised NPAT (\$m)                                     | 361.7     | 334.0   | 328.7   | 179.6    | 182.1     | 179.1   | 154.9   | 165.2   | 163.5   |
| Statutory NPAT (\$m)                                      | 327.7     | 299.0   | 340.6   | 93.4     | 234.3     | 168.9   | 130.1   | 174.3   | 166.3   |
| Normalised EBIT (\$m)                                     | 471.5     | 438.4   | 387.9   | 232.8    | 238.7     | 232.0   | 206.4   | 195.1   | 192.8   |
| Underlying operating cash flow (\$m)                      | 297.1     | 287.9   | 321.0   | 149.7    | 147.4     | 194.3   | 93.6    | 177.6   | 143.4   |
| Normalised cost to income ratio                           | 34.6%     | 33.8%   | 34.6%   | 35.4%    | 33.8%     | 33.3%   | 34.4%   | 35.2%   | 34.0%   |
| Normalised effective tax rate                             | 22.6%     | 23.1%   | 14.4%   | 22.3%    | 23.0%     | 22.1%   | 24.3%   | 14.5%   | 14.2%   |
| Normalised effective tax rate excluding TOFA <sup>1</sup> | 22.6%     | 23.1%   | 22.2%   | 22.3%    | 23.0%     | 22.1%   | 24.3%   | 22.3%   | 22.1%   |
| <b>Earnings per share (cents)</b>                         |           |         |         |          |           |         |         |         |         |
| Basic – normalised                                        | 64.6      | 61.2    | 64.0    | 32.0     | 32.6      | 32.4    | 28.8    | 32.2    | 31.8    |
| Basic – normalised excluding TOFA <sup>1</sup>            | 64.6      | 61.2    | 58.1    | 32.0     | 32.6      | 32.4    | 28.8    | 29.3    | 28.9    |
| Basic – statutory                                         | 58.5      | 54.8    | 66.3    | 16.6     | 41.9      | 30.5    | 24.2    | 34.0    | 32.3    |
| Diluted – normalised                                      | 60.9      | 57.2    | 60.6    | 30.3     | 30.5      | 30.0    | 27.0    | 30.4    | 30.3    |
| Diluted – normalised excluding TOFA <sup>1</sup>          | 60.9      | 57.2    | 55.1    | 30.3     | 30.5      | 30.0    | 27.0    | 27.6    | 27.5    |
| Diluted – statutory                                       | 55.4      | 51.4    | 62.8    | 16.3     | 39.0      | 28.3    | 22.8    | 32.1    | 30.8    |
| <b>Return on equity (%)</b>                               |           |         |         |          |           |         |         |         |         |
| Normalised Return on Equity (ROE) – pre-tax               | 17.8%     | 18.0%   | 18.8%   | 17.4%    | 18.1%     | 18.6%   | 17.4%   | 18.6%   | 18.9%   |
| Normalised Return on Equity (ROE) – post-tax              | 13.7%     | 13.9%   | 16.1%   | 13.6%    | 14.0%     | 14.5%   | 13.2%   | 15.9%   | 16.2%   |
| Statutory Return on Equity (ROE) – post-tax               | 12.5%     | 12.4%   | 16.7%   | 7.1%     | 18.0%     | 13.7%   | 11.1%   | 16.8%   | 16.5%   |
| <b>Capital management</b>                                 |           |         |         |          |           |         |         |         |         |
| Net assets – average <sup>2</sup> (\$m)                   | 2,631     | 2,410   | 2,044   | 2,664    | 2,592     | 2,494   | 2,331   | 2,090   | 2,000   |
| Net assets – closing (\$m)                                | 2,681     | 2,543   | 2,153   | 2,681    | 2,696     | 2,543   | 2,443   | 2,153   | 2,052   |
| Net assets per basic share (\$)                           | 4.80      | 4.60    | 4.22    | 4.80     | 4.80      | 4.60    | 4.42    | 4.22    | 3.99    |
| Net tangible assets (\$m)                                 | 2,097     | 1,994   | 1,607   | 2,097    | 2,111     | 1,994   | 1,896   | 1,607   | 1,530   |
| Net tangible assets per basic share (\$)                  | 3.75      | 3.60    | 3.15    | 3.75     | 3.75      | 3.60    | 3.43    | 3.15    | 2.98    |
| Dividend (cps)                                            | 32.5      | 30.0    | 26.0    | 16.5     | 16.0      | 15.5    | 14.5    | 13.5    | 12.5    |
| Dividend franking (%)                                     | 100.0     | 85.5    | 20.8    | 100.0    | 100.0     | 100.0   | 70.0    | 40.0    | –       |
| Normalised dividend payout ratio                          | 50.3%     | 49.0%   | 40.6%   | 51.6%    | 49.1%     | 47.8%   | 50.4%   | 41.9%   | 39.3%   |
| <b>Sales, net flows and assets under management</b>       |           |         |         |          |           |         |         |         |         |
| Life sales (\$m)                                          |           |         |         |          |           |         |         |         |         |
| Annuity sales (\$m)                                       | 3,351.2   | 2,753.1 | 2,798.8 | 1,710.1  | 1,641.1   | 1,178.3 | 1,574.8 | 1,341.8 | 1,457.0 |
| Other Life sales (\$m)                                    | 998.5     | 944.0   | 581.6   | 588.8    | 409.7     | 395.1   | 548.9   | 291.5   | 290.1   |
| Total Life sales (\$m)                                    | 4,349.7   | 3,697.1 | 3,380.4 | 2,298.9  | 2,050.8   | 1,573.4 | 2,123.7 | 1,633.3 | 1,747.1 |
| Life annuity net flows <sup>3</sup> (\$m)                 |           |         |         |          |           |         |         |         |         |
| Life annuity net flows <sup>3</sup> (\$m)                 | 740.4     | 738.2   | 887.1   | 469.9    | 270.5     | 177.4   | 560.8   | 347.2   | 539.9   |
| Life annuity book (\$m)                                   | 9,558.5   | 8,692.6 | 7,824.3 | 9,558.5  | 8,868.4   | 8,692.6 | 8,573.1 | 7,824.3 | 7,617.2 |
| Life annuity net book growth <sup>3</sup>                 | 8.5%      | 9.4%    | 12.5%   | 5.4%     | 3.1%      | 2.2%    | 7.2%    | 4.6%    | 7.6%    |
| Total Life net flows <sup>3</sup> (\$m)                   | 1,068.3   | 650.9   | 176.1   | 721.2    | 347.1     | 212.5   | 438.4   | 388.2   | (212.1) |
| Total Life book <sup>4</sup> (\$m)                        |           |         |         |          |           |         |         |         |         |
| Total Life book <sup>4</sup> (\$m)                        | 10,874.0  | 9,637.7 | 8,896.7 | 10,874.0 | 9,903.5   | 9,637.7 | 9,527.9 | 8,896.7 | 8,617.5 |
| Total Life net book growth <sup>3</sup>                   | 11.1%     | 7.3%    | 2.0%    | 7.5%     | 3.6%      | 2.4%    | 4.9%    | 4.4%    | (2.4%)  |
| Funds Management – net flows <sup>5</sup> (\$m)           |           |         |         |          |           |         |         |         |         |
| Funds Management – net flows <sup>5</sup> (\$m)           | (2,517.2) | 7,738.9 | 2,147.4 | 1,839.2  | (4,356.4) | 972.7   | 6,766.2 | 1,033.6 | 1,113.8 |
| Total assets under management <sup>6</sup>                |           |         |         |          |           |         |         |         |         |
| Total assets under management <sup>6</sup>                | 60,051    | 59,789  | 50,725  | 60,051   | 57,617    | 59,789  | 57,169  | 50,725  | 48,814  |
| <b>Other</b>                                              |           |         |         |          |           |         |         |         |         |
| Headcount – closing FTEs                                  | 635       | 560     | 539     | 635      | 618       | 560     | 563     | 539     | 498     |
| Weighted average number of basic shares on issue (m)      | 560.2     | 545.7   | 513.8   | 561.2    | 559.1     | 553.2   | 538.2   | 513.1   | 514.5   |
| Number of basic shares on issue (m)                       | 558.8     | 553.4   | 510.6   | 558.8    | 562.2     | 553.4   | 552.9   | 510.6   | 514.1   |
| Share price closing (\$)                                  | 8.63      | 6.72    | 7.44    | 8.63     | 8.72      | 6.72    | 6.53    | 7.44    | 6.20    |

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 \$30m in FY14 (1H14 \$15m; 2H14 \$15m).

2. Net assets – average calculated on a monthly basis.

3. 2H14 and FY14 excludes \$284m maturity of the High Yield Fund annuity.

4. Total Life book includes the Life annuity book and Guaranteed Index Return liabilities.

5. Funds Management 1H16 and FY16 net flows include \$5.4bn derecognition of Kapstream following the sale in July 2015. Fidante Partners will no longer receive distribution fees on Kapstream institutional FUM (\$5.4bn) and as a result has derecognised this FUM. Despite the reduction in FUM, Fidante Partners earnings over the short and medium term are not expected to be negatively impacted following new distribution and administration agreements.

6. Refer to page 37 for a reconciliation of total Group Assets and Funds Under Management.

## Consolidated profit and loss

| \$m                                                       | FY16           | FY15           | FY14           | 2H16           | 1H16           | 2H15           | 1H15           | 2H14           | 1H14          |
|-----------------------------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|---------------|
| Cash earnings                                             | 491.9          | 463.4          | 425.7          | 247.4          | 244.5          | 240.1          | 223.3          | 214.4          | 211.3         |
| Normalised capital growth                                 | 100.5          | 80.4           | 55.6           | 52.1           | 48.4           | 45.9           | 34.5           | 29.7           | 25.9          |
| <b>Normalised Cash Operating Earnings (COE)</b>           | <b>592.4</b>   | <b>543.8</b>   | <b>481.3</b>   | <b>299.5</b>   | <b>292.9</b>   | <b>286.0</b>   | <b>257.8</b>   | <b>244.1</b>   | <b>237.2</b>  |
| Net fee income                                            | 127.7          | 117.5          | 110.2          | 60.6           | 67.1           | 61.4           | 56.1           | 56.4           | 53.8          |
| Other income                                              | 1.0            | 1.3            | 1.8            | 0.4            | 0.6            | 0.6            | 0.7            | 0.6            | 1.2           |
| <b>Total net income</b>                                   | <b>721.1</b>   | <b>662.6</b>   | <b>593.3</b>   | <b>360.5</b>   | <b>360.6</b>   | <b>348.0</b>   | <b>314.6</b>   | <b>301.1</b>   | <b>292.2</b>  |
| Personnel expenses                                        | (172.8)        | (154.8)        | (144.4)        | (89.0)         | (83.8)         | (78.3)         | (76.5)         | (74.8)         | (69.6)        |
| Other expenses                                            | (76.8)         | (69.4)         | (61.0)         | (38.7)         | (38.1)         | (37.7)         | (31.7)         | (31.2)         | (29.8)        |
| <b>Total expenses</b>                                     | <b>(249.6)</b> | <b>(224.2)</b> | <b>(205.4)</b> | <b>(127.7)</b> | <b>(121.9)</b> | <b>(116.0)</b> | <b>(108.2)</b> | <b>(106.0)</b> | <b>(99.4)</b> |
| <b>Normalised EBIT</b>                                    | <b>471.5</b>   | <b>438.4</b>   | <b>387.9</b>   | <b>232.8</b>   | <b>238.7</b>   | <b>232.0</b>   | <b>206.4</b>   | <b>195.1</b>   | <b>192.8</b>  |
| Interest and borrowing costs                              | (4.1)          | (3.8)          | (4.1)          | (1.8)          | (2.3)          | (2.1)          | (1.7)          | (1.9)          | (2.2)         |
| <b>Normalised profit before tax</b>                       | <b>467.4</b>   | <b>434.6</b>   | <b>383.8</b>   | <b>231.0</b>   | <b>236.4</b>   | <b>229.9</b>   | <b>204.7</b>   | <b>193.2</b>   | <b>190.6</b>  |
| Normalised tax <sup>1</sup>                               | (105.7)        | (100.6)        | (55.1)         | (51.4)         | (54.3)         | (50.8)         | (49.8)         | (28.0)         | (27.1)        |
| <b>Normalised profit after-tax</b>                        | <b>361.7</b>   | <b>334.0</b>   | <b>328.7</b>   | <b>179.6</b>   | <b>182.1</b>   | <b>179.1</b>   | <b>154.9</b>   | <b>165.2</b>   | <b>163.5</b>  |
| Investment expense after-tax                              | (56.1)         | (35.0)         | 11.9           | (86.2)         | 30.1           | (10.2)         | (24.8)         | 9.1            | 2.8           |
| Significant items after-tax <sup>2</sup>                  | 22.1           | –              | –              | –              | 22.1           | –              | –              | –              | –             |
| <b>Statutory net profit after-tax</b>                     | <b>327.7</b>   | <b>299.0</b>   | <b>340.6</b>   | <b>93.4</b>    | <b>234.3</b>   | <b>168.9</b>   | <b>130.1</b>   | <b>174.3</b>   | <b>166.3</b>  |
| <b>Performance analysis</b>                               |                |                |                |                |                |                |                |                |               |
| Normalised earnings per share – basic (cents)             | 64.6           | 61.2           | 64.0           | 32.0           | 32.6           | 32.4           | 28.8           | 32.2           | 31.8          |
| Shares for basic EPS calculation                          | 560.2          | 545.7          | 513.8          | 561.2          | 559.1          | 553.2          | 538.2          | 513.1          | 514.5         |
| Normalised cost to income ratio                           | 34.6%          | 33.8%          | 34.6%          | 35.4%          | 33.8%          | 33.3%          | 34.4%          | 35.2%          | 34.0%         |
| Normalised effective tax rate                             | 22.6%          | 23.1%          | 14.4%          | 22.3%          | 23.0%          | 22.1%          | 24.3%          | 14.5%          | 14.2%         |
| Normalised effective tax rate excluding TOFA <sup>1</sup> | 22.6%          | 23.1%          | 22.2%          | 22.3%          | 23.0%          | 22.1%          | 24.3%          | 22.3%          | 22.1%         |
| <b>Total net income analysis</b>                          |                |                |                |                |                |                |                |                |               |
| Cash earnings (Life)                                      | 68.2%          | 69.9%          | 71.7%          | 68.6%          | 67.8%          | 69.0%          | 71.0%          | 71.2%          | 72.3%         |
| Normalised capital growth (Life)                          | 14.0%          | 12.1%          | 9.4%           | 14.5%          | 13.4%          | 13.2%          | 11.0%          | 9.9%           | 8.9%          |
| Net fee income (Funds Management)                         | 17.7%          | 17.7%          | 18.6%          | 16.8%          | 18.6%          | 17.6%          | 17.8%          | 18.7%          | 18.4%         |
| Other income (Corporate)                                  | 0.1%           | 0.2%           | 0.3%           | 0.1%           | 0.2%           | 0.2%           | 0.2%           | 0.2%           | 0.4%          |
| <b>Normalised EBIT by division</b>                        |                |                |                |                |                |                |                |                |               |
| Life                                                      | 499.8          | 456.7          | 404.2          | 250.9          | 248.9          | 240.9          | 215.8          | 203.6          | 200.6         |
| Funds Management                                          | 37.4           | 44.1           | 43.3           | 15.8           | 21.6           | 23.3           | 20.8           | 22.6           | 20.7          |
| Corporate                                                 | (65.7)         | (62.4)         | (59.6)         | (33.9)         | (31.8)         | (32.2)         | (30.2)         | (31.1)         | (28.5)        |
| <b>Normalised EBIT</b>                                    | <b>471.5</b>   | <b>438.4</b>   | <b>387.9</b>   | <b>232.8</b>   | <b>238.7</b>   | <b>232.0</b>   | <b>206.4</b>   | <b>195.1</b>   | <b>192.8</b>  |

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 \$30m in FY14 (1H14 \$15m; 2H14 \$15m).

2. FY16 significant items after-tax primarily represents the gain on sale of Challenger's equity investment in Kapstream, offset by boutique impairments and office relocation costs.

## Normalised profit after-tax

FY16 normalised profit after-tax was \$362m, up \$28m (8%) from \$334m in FY15. The increase in normalised profit after-tax reflects a \$33m (8%) increase in EBIT, partially offset by higher normalised tax (up \$5m).

EBIT increased as a result of strong assets under management (AUM) growth, driving a \$59m (9%) increase in net income, which was partially offset by a \$25m (11%) increase in expenses. The increase in both net income and expenses includes the impact of Fidante Partners Europe (formerly Dexion Capital) following its acquisition in July 2015 (refer to page 40).

## Normalised earnings per share (EPS)

Normalised EPS increased by 6% from 61.2 cps in FY15 to 64.6 cps in FY16. The increase in normalised EPS reflects higher normalised profit after-tax (up \$28m), partially offset by an increase in the weighted average number of shares on issue. The weighted average number of shares on issue was 3% higher than in FY15, reflecting the institutional placement and Share Placement Plan undertaken in mid-1H15 and shares issued as part of Challenger's Dividend Reinvestment Plan during FY16.

## Total net income

Total net income increased by \$59m (9%) in FY16 due to:

- \$49m increase (up 9%) in Life Cash Operating Earnings from an increase in Life average AUM (up 8%) with a stable Life COE margin (4.5%); and
- \$10m (up 9%) increase in Funds Management net fee income as a result of an increase in average FUM and including Fidante Partners Europe income.

## Expenses

FY16 total expenses were \$250m, up \$25m (11%) on FY15. The increase in expenses relate to higher personnel costs (up \$18m) as a result of an increase in employee numbers, and higher other expenses (up \$7m). Fidante Partners Europe contributed \$17m of the overall expense increase.

Full Time Equivalent (FTE) employees at 30 June 2016 was 635, and increased by 75 FTEs (13%) during the year and includes approximately 40 FTEs in Fidante Partners Europe.

In FY16, the cost to income ratio rose by 80 bps to 34.6%, however is within Challenger's targeted normalised cost to income ratio range of between 32% and 36%. The increase in normalised cost to income ratio was impacted by the operating performance of Fidante Partners Europe (refer to page 40 for more detail).

Challenger remains one of Australia's most efficient financial services companies with a cost to income ratio that is 13 percentage points lower than the average ratio across ASX100 banks and diversified financial companies.

## Normalised EBIT

FY16 normalised EBIT was \$472m, and increased by \$33m (8%) from \$438m in FY15. EBIT increased by \$43m (9%) in Life, while Funds Management decreased by \$7m (15%) and Corporate decreased by \$3m (5%).

The increase in Life normalised EBIT reflects an increase in average AUM, which increased by 8%, and a stable Life COE margin. Life's COE margin was stable at 4.5% in FY16, and has been in the range of 4.4% to 4.5% for eight consecutive half year periods since 1H13. Refer to page 12 for more detail on Life's COE margin.

The decrease in Funds Management EBIT reflects low transaction activity in the United Kingdom due to Brexit uncertainty, resulting in a \$10m pre-tax loss for the Fidante Partners Europe business (refer to page 40 for more detail).

Corporate EBIT was \$3m lower in FY16 due to an increase in other expenses (up \$3m). Refer to page 41 for more detail.

## Normalised Return on Equity (ROE)

FY16 normalised ROE was 17.8% and decreased by 20 bps for the year. The decrease in ROE is due to the Fidante Partners Europe loss (\$10m pre-tax). Excluding this loss, Challenger's normalised pre-tax return on equity was 18.1% and above Challenger's long-term 18% ROE target.

## Normalised tax

Normalised tax was \$106m in FY16 with an effective tax rate of 22.6% and is consistent with prior periods.

The FY16 normalised effective tax rate reflects Challenger's current business mix and is currently slightly below Challenger's medium term expected normalised effective tax rate range of between 23% and 25%.

## Investment experience after-tax

Challenger Life is required by Australian accounting standards to value investment assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on investment 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 relates to the Life business and pre-tax investment experience is disclosed as part of Life's financial results. FY16 investment experience was a pre-tax loss of \$68m (refer to page 13 for more detail) and investment experience post-tax was \$56m.

The FY16 effective tax rate applicable to investment experience was 18%, and is lower than Australia's corporate tax rate (30%) mainly due to non-deductible investment losses (\$8m). Over the medium term, Challenger expects the effective tax rate applicable to investment experience to be approximately 30%.

### Significant items after-tax

Significant one-off items were positive \$22m (after-tax) in FY16 and represent non-recurring and abnormal income and expense items.

FY16 significant items include a \$40m profit resulting from the sale of Kapstream, partially offset by boutique impairment costs (\$12m) following the closure of Metisq and Arête (refer to page 39 for more detail) and one-off expenses (\$3m) related to relocating Challenger's Sydney head office.

### Statutory net profit after-tax

Statutory net profit after-tax includes after-tax investment experience and significant one-off items.

Statutory net profit after-tax in FY16 was \$328m, up \$29m (10%) from \$299m in FY15. The increase in statutory net profit after-tax reflects higher normalised profit after-tax (up \$28m) and significant one-off items (up \$22m) offset by lower after-tax investment experience (down \$21m).

## Dividends

### Final FY16 dividend

A final dividend in respect of FY16 of 16.5 cents per share (100% franked) has been declared, and is up 6% on the final FY15 dividend. Dividend dates are as follows:

- Ex-date: 1 September 2016;
- Record date: 2 September 2016;
- Final DRP election date: 5 September 2016; and
- Dividend payment date: 28 September 2016.

### Total FY16 dividend

The total FY16 dividend was 32.5 cents per share and is up 8% on the total FY15 dividend. The normalised dividend payout ratio for the FY16 dividend was 50%, and is within Challenger's dividend payout ratio guidance of between 45% and 50% of normalised profit after-tax.

Challenger's franking account balance at 30 June 2016 was \$47m.

### Dividend Reinvestment Plan

With the return to full dividend franking, the Challenger Limited Board established a Dividend Reinvestment Plan (DRP) commencing for the final FY15 dividend, which was paid in September 2015. The DRP provides an effective way for shareholders to reinvest their dividends and increase their shareholding in Challenger without incurring any transaction costs.

The DRP participation rate for the final FY15 dividend (paid in September 2015) and interim FY16 dividend (paid in March 2016) was 6% of issued capital, with 1.5m new Challenger shares issued. Under the terms of the DRP, new Challenger shares were issued based on a ten day Challenger share VWAP, with no share price discount applied.

The DRP had the effect of reducing the effective cash dividend payout ratio for the full year from 50% to 47%.

For the FY16 final dividend, the Board has determined that new Challenger shares will be issued to fulfil DRP requirements, and will continue to be issued based on a ten day Challenger share VWAP, with no discount applied.

## Credit ratings

In December 2015, Standard & Poor's (S&P) affirmed both Challenger Life Company (CLC) and Challenger Limited's credit 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, the report noted that "Challenger Life has an extremely strong capital and earnings position".

## FY17 guidance

### Life COE

Life FY17 COE guidance is a range of \$620m to \$640m (FY16 actual \$592m). FY17 COE guidance considers the potential impact of lower interest rates on shareholder capital, with shareholder capital not hedged for movements in interest rates.

### Dividend policy

Challenger targets a dividend payout ratio in the range of 45% to 50% of normalised profit after-tax and aims to frank dividends to the maximum extent possible. Based on current expectations, the Board expects future dividends to be fully franked. However, the actual dividend payout ratio and franking levels will depend on prevailing market conditions and capital allocation priorities.

### Cost to income ratio

Challenger's business remains one of Australia's most efficient financial services companies and is scalable. Challenger targets a normalised cost to income ratio in the range of 32% to 36%.

## Group balance sheet<sup>1</sup>

| \$m                                       | FY16            | 1H16            | FY15            | 1H15            | FY14            | 1H14            |
|-------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| <b>Assets</b>                             |                 |                 |                 |                 |                 |                 |
| <b>Life investment assets</b>             |                 |                 |                 |                 |                 |                 |
| Fixed income and cash (net)               | 9,315.5         | 8,487.6         | 8,513.7         | 8,541.1         | 7,955.7         | 7,983.2         |
| Property (net)                            | 3,150.0         | 3,063.2         | 2,883.7         | 2,716.4         | 2,167.8         | 1,952.0         |
| Equity and other investments              | 1,079.0         | 1,060.0         | 882.8           | 632.4           | 400.7           | 433.1           |
| Infrastructure (net)                      | 567.2           | 536.4           | 514.4           | 503.0           | 563.2           | 520.9           |
| <b>Life investment assets</b>             | <b>14,111.7</b> | <b>13,147.2</b> | <b>12,794.6</b> | <b>12,392.9</b> | <b>11,087.4</b> | <b>10,889.2</b> |
| Cash and cash equivalents (Group cash)    | 84.2            | 89.3            | 98.6            | 126.0           | 141.2           | 154.8           |
| Receivables                               | 120.2           | 148.5           | 175.7           | 217.4           | 181.9           | 281.8           |
| Derivative assets                         | 354.2           | 292.6           | 255.0           | 356.6           | 326.3           | 245.2           |
| Investment in associates                  | 51.5            | 30.2            | 43.4            | 39.4            | 39.4            | 36.4            |
| Other assets                              | 48.0            | 50.7            | 27.3            | 42.6            | 27.9            | 49.8            |
| Fixed assets                              | 34.9            | 34.3            | 8.4             | 10.9            | 12.4            | 12.3            |
| Goodwill and intangibles                  | 583.9           | 585.5           | 549.4           | 547.2           | 545.8           | 522.1           |
| Less Group/Life eliminations <sup>2</sup> | (105.3)         | (123.0)         | (136.5)         | (154.9)         | (182.2)         | (202.3)         |
| <b>Total assets</b>                       | <b>15,283.3</b> | <b>14,255.3</b> | <b>13,815.9</b> | <b>13,578.1</b> | <b>12,180.1</b> | <b>11,989.3</b> |
| <b>Liabilities</b>                        |                 |                 |                 |                 |                 |                 |
| Payables                                  | 228.6           | 184.9           | 180.1           | 191.0           | 190.7           | 191.7           |
| Tax liabilities                           | 162.6           | 182.4           | 155.3           | 150.4           | 165.7           | 161.2           |
| Derivative liabilities                    | 409.5           | 352.8           | 370.6           | 344.5           | 222.1           | 327.2           |
| Subordinated debt                         | 576.7           | 576.5           | 567.0           | 560.7           | 525.9           | 509.5           |
| Challenger Capital Notes                  | 338.5           | 337.7           | 336.8           | 336.2           | –               | –               |
| Other interest bearing liabilities        | –               | –               | 1.4             | 4.0             | 3.2             | 103.8           |
| Provisions                                | 12.5            | 21.3            | 23.8            | 20.5            | 22.5            | 26.1            |
| Life annuity book                         | 9,558.5         | 8,868.4         | 8,693.0         | 8,573.1         | 7,824.3         | 7,617.2         |
| Guaranteed Index Return (GIR) liabilities | 1,315.5         | 1,035.1         | 944.7           | 954.8           | 1,072.4         | 1,000.3         |
| <b>Total liabilities</b>                  | <b>12,602.4</b> | <b>11,559.1</b> | <b>11,272.7</b> | <b>11,135.2</b> | <b>10,026.8</b> | <b>9,937.0</b>  |
| <b>Group net assets</b>                   | <b>2,680.9</b>  | <b>2,696.2</b>  | <b>2,543.2</b>  | <b>2,442.9</b>  | <b>2,153.3</b>  | <b>2,052.3</b>  |
| <b>Equity</b>                             |                 |                 |                 |                 |                 |                 |
| Contributed equity                        | 1,546.7         | 1,576.8         | 1,527.2         | 1,524.3         | 1,237.5         | 1,263.2         |
| Reserves                                  | (7.9)           | (19.7)          | 23.7            | 13.8            | 69.8            | 52.1            |
| Retained earnings                         | 1,142.1         | 1,139.1         | 992.3           | 904.8           | 846.0           | 737.0           |
| <b>Total equity</b>                       | <b>2,680.9</b>  | <b>2,696.2</b>  | <b>2,543.2</b>  | <b>2,442.9</b>  | <b>2,153.3</b>  | <b>2,052.3</b>  |

## Change in Group net assets

| \$m                            | 2H16           | 1H16           | 2H15           | 1H15           | 2H14           | 1H14           |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>Opening net assets</b>      | <b>2,696.2</b> | <b>2,543.2</b> | <b>2,442.9</b> | <b>2,153.3</b> | <b>2,052.3</b> | <b>1,947.4</b> |
| Statutory net profit after-tax | 93.4           | 234.3          | 168.9          | 130.1          | 174.3          | 166.3          |
| Dividends paid                 | (90.4)         | (87.5)         | (81.4)         | (71.3)         | (65.3)         | (55.0)         |
| New share issue                | 4.9            | 6.3            | –              | 287.2          | –              | –              |
| Reserve movements              | 11.8           | (43.4)         | 9.9            | (56.0)         | 17.7           | 2.3            |
| CPP Trust movements            | (35.0)         | 43.3           | 2.9            | (0.4)          | (25.7)         | (8.7)          |
| <b>Closing net assets</b>      | <b>2,680.9</b> | <b>2,696.2</b> | <b>2,543.2</b> | <b>2,442.9</b> | <b>2,153.3</b> | <b>2,052.3</b> |

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 Challenger Life Company Ltd.



## Issued share capital

| Number of shares (m)                         | FY16         | FY15         | FY14         | 2H16         | 1H16         | 2H15         | 1H15         | 2H14         | 1H14         |
|----------------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Basic share count                            | 558.8        | 553.4        | 510.6        | 558.8        | 562.2        | 553.4        | 552.9        | 510.6        | 514.1        |
| CPP 'treasury' shares                        | 12.4         | 16.3         | 20.3         | 12.4         | 8.4          | 16.3         | 16.8         | 20.3         | 16.8         |
| <b>Total issued shares</b>                   | <b>571.2</b> | <b>569.7</b> | <b>530.9</b> | <b>571.2</b> | <b>570.6</b> | <b>569.7</b> | <b>569.7</b> | <b>530.9</b> | <b>530.9</b> |
| <b>Movement in basic share count</b>         |              |              |              |              |              |              |              |              |              |
| Opening                                      | 553.4        | 510.6        | 515.6        | 562.2        | 553.4        | 552.9        | 510.6        | 514.1        | 515.6        |
| CPP deferred share purchase                  | (4.0)        | (4.6)        | (3.0)        | (4.0)        | –            | –            | (4.6)        | –            | (3.0)        |
| Net treasury shares (acquired)/released      | 7.9          | 8.6          | (2.0)        | –            | 7.9          | 0.5          | 8.1          | (3.5)        | 1.5          |
| New share issues                             | 1.5          | 38.8         | –            | 0.6          | 0.9          | –            | 38.8         | –            | –            |
| Closing                                      | 558.8        | 553.4        | 510.6        | 558.8        | 562.2        | 553.4        | 552.9        | 510.6        | 514.1        |
| <b>Movement in CPP 'treasury' shares</b>     |              |              |              |              |              |              |              |              |              |
| Opening                                      | 16.3         | 20.3         | 15.3         | 8.4          | 16.3         | 16.8         | 20.3         | 16.8         | 15.3         |
| Shares vested to participants                | (9.5)        | (14.1)       | (3.7)        | (0.5)        | (9.0)        | (0.5)        | (13.6)       | (0.4)        | (3.3)        |
| CPP deferred share purchase                  | 4.0          | 4.6          | 3.0          | 4.0          | –            | –            | 4.6          | –            | 3.0          |
| Shares bought into CPP Trust                 | 1.6          | 5.5          | 5.7          | 0.5          | 1.1          | –            | 5.5          | 3.9          | 1.8          |
| Closing                                      | 12.4         | 16.3         | 20.3         | 12.4         | 8.4          | 16.3         | 16.8         | 20.3         | 16.8         |
| <b>Share capital for EPS calculations</b>    |              |              |              |              |              |              |              |              |              |
| Weighted average number of shares (m)        | FY16         | FY15         | FY14         | 2H16         | 1H16         | 2H15         | 1H15         | 2H14         | 1H14         |
| <b>Basic EPS shares</b>                      |              |              |              |              |              |              |              |              |              |
| Total issued shares                          | 570.5        | 562.8        | 530.9        | 570.9        | 570.1        | 569.7        | 556.0        | 530.9        | 530.9        |
| Less CPP 'treasury' shares                   | (10.3)       | (17.1)       | (17.1)       | (9.7)        | (11.0)       | (16.5)       | (17.8)       | (17.8)       | (16.4)       |
| Shares for basic EPS calculation             | 560.2        | 545.7        | 513.8        | 561.2        | 559.1        | 553.2        | 538.2        | 513.1        | 514.5        |
| <b>Diluted EPS shares</b>                    |              |              |              |              |              |              |              |              |              |
| Shares for basic EPS calculation             | 560.2        | 545.7        | 513.8        | 561.2        | 559.1        | 553.2        | 538.2        | 513.1        | 514.5        |
| Add dilutive impact of equity awards schemes | 16.8         | 20.7         | 28.2         | 15.7         | 17.7         | 18.6         | 23.0         | 30.4         | 25.8         |
| Add dilutive impact of capital notes         | 39.1         | 37.1         | –            | 39.1         | 41.6         | 51.2         | 25.4         | –            | –            |
| Shares for dilutive EPS calculation          | 616.1        | 603.5        | 542.0        | 616.0        | 618.4        | 623.0        | 586.6        | 543.5        | 540.3        |
| <b>Summary of Share Rights</b>               |              |              |              |              |              |              |              |              |              |
| Number (m)                                   | FY16         | FY15         | FY14         | 2H16         | 1H16         | 2H15         | 1H15         | 2H14         | 1H14         |
| <b>Hurdled Performance Share Rights</b>      |              |              |              |              |              |              |              |              |              |
| Opening                                      | 17.3         | 26.6         | 21.8         | 13.0         | 17.3         | 17.6         | 26.6         | 27.0         | 21.8         |
| New grants                                   | 3.4          | 2.6          | 6.6          | –            | 3.4          | 0.2          | 2.4          | –            | 6.6          |
| Vesting/forfeiture                           | (8.2)        | (11.9)       | (1.8)        | (0.5)        | (7.7)        | (0.5)        | (11.4)       | (0.4)        | (1.4)        |
| <b>Closing</b>                               | <b>12.5</b>  | <b>17.3</b>  | <b>26.6</b>  | <b>12.5</b>  | <b>13.0</b>  | <b>17.3</b>  | <b>17.6</b>  | <b>26.6</b>  | <b>27.0</b>  |
| <b>Deferred Performance Share Rights</b>     |              |              |              |              |              |              |              |              |              |
| Opening                                      | 3.5          | 3.8          | 3.3          | 3.8          | 3.5          | 3.6          | 3.8          | 3.8          | 3.3          |
| New grants                                   | 2.3          | 2.3          | 2.5          | –            | 2.3          | –            | 2.3          | –            | 2.5          |
| Vesting/forfeiture                           | (2.0)        | (2.6)        | (2.0)        | –            | (2.0)        | (0.1)        | (2.5)        | –            | (2.0)        |
| Closing                                      | 3.8          | 3.5          | 3.8          | 3.8          | 3.8          | 3.5          | 3.6          | 3.8          | 3.8          |



## Issued share capital

### Issued share capital and diluted share count

The number of Challenger Limited shares listed on the Australian Securities Exchange (ASX) at 30 June 2016 was 571m shares, and increased by 1.5m shares in FY16. The increase in the number of shares on issue reflects new shares issued as a result of the September 2015 and March 2016 Dividend Reinvestment Plan (DRP).

The basic share count is used to determine Challenger's normalised and statutory EPS and 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; 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.

In FY16 the basic share count increased by 5.4m shares following the net release of treasury shares in order to meet Challenger Performance Plan requirements and 1.5m new shares issued under the DRP.

### Treasury shares

The Challenger Performance Plan (CPP) Trust was established to purchase shares 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. The use of forward share purchase agreements was implemented in FY13 to increase capital efficiency. Shares held by the CPP Trust are classified as treasury shares.

It is expected that should equity awards vest in the future, the CPP Trust will satisfy equity requirements via a combination of treasury shares and settlement of forward purchase agreements. As such, it is not anticipated that new 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 Long Term Incentive (LTI) awards to ensure alignment between key employees and shareholders. LTI awards are delivered as HPSRs, which vest over a period of up to five years and are subject to meeting total shareholder return performance hurdles and continued employment before vesting.

### Deferred Performance Share Rights (DPSRs)

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

## Challenger Capital Notes

In October 2014, Challenger issued Challenger Capital Notes to the value of \$345m, which are subordinated, unsecured convertible notes issued by Challenger Limited.

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 they are included in the dilutive share count.

At 30 June 2016, Challenger Capital Notes have been considered under Australian accounting standards to be dilutive and are included in Challenger's 30 June 2016 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 meeting certain conditions. However, Challenger also retains the option to redeem or resell Challenger Capital Notes and has an outright option to redeem or resell on 25 May 2020 (both subject to certain conditions being met). If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes to Challenger ordinary shares and subsequent shareholder dilution.

## Consolidated operating cash flow

| \$m                                             | FY16           | FY15         | FY14         | 2H16         | 1H16         | 2H15         | 1H15         | 2H14         | 1H14           |
|-------------------------------------------------|----------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|----------------|
| Receipts from customers                         | 598.4          | 543.0        | 508.5        | 317.2        | 281.2        | 288.8        | 254.2        | 259.5        | 249.0          |
| Dividends received                              | 56.4           | 77.1         | 61.2         | 24.2         | 32.2         | 43.1         | 34.0         | 34.3         | 26.9           |
| Interest received                               | 639.1          | 585.9        | 549.3        | 294.3        | 344.8        | 316.3        | 269.6        | 279.1        | 270.2          |
| Interest paid                                   | (444.8)        | (438.7)      | (406.5)      | (221.0)      | (223.8)      | (225.3)      | (213.4)      | (203.1)      | (203.4)        |
| Payments to suppliers and employees             | (488.1)        | (413.7)      | (377.3)      | (231.6)      | (256.5)      | (206.6)      | (207.1)      | (180.2)      | (197.1)        |
| Income tax paid                                 | (63.9)         | (65.7)       | (14.2)       | (33.4)       | (30.5)       | (22.0)       | (43.7)       | (12.0)       | (2.2)          |
| <b>Underlying operating cash flow</b>           | <b>297.1</b>   | <b>287.9</b> | <b>321.0</b> | <b>149.7</b> | <b>147.4</b> | <b>194.3</b> | <b>93.6</b>  | <b>177.6</b> | <b>143.4</b>   |
| Adjust for:                                     |                |              |              |              |              |              |              |              |                |
| Net annuity policy capital receipts             | 740.4          | 738.2        | 603.4        | 469.9        | 270.5        | 177.4        | 560.8        | 63.5         | 539.9          |
| Net other Life capital (payments)/ receipts     | 309.0          | (186.7)      | (745.1)      | 230.1        | 78.9         | (16.7)       | (170.0)      | 25.3         | (770.4)        |
| Other <sup>1</sup>                              | (64.1)         | (23.5)       | (31.9)       | (34.9)       | (29.2)       | (7.7)        | (15.8)       | (5.5)        | (26.4)         |
| <b>Operating cash flow per financial report</b> | <b>1,282.4</b> | <b>815.9</b> | <b>147.4</b> | <b>814.8</b> | <b>467.6</b> | <b>347.3</b> | <b>468.6</b> | <b>260.9</b> | <b>(113.5)</b> |

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

FY16 underlying operating cash flow was \$297m, up from \$288m in FY15.

FY16 underlying operating cash flow varies from FY16 normalised net profit after-tax (\$362m) mainly due to normalised capital growth (\$101m pre-tax and is a non-cash item) and timing differences in respect of income tax.

### Net annuity policy capital receipts

Net annuity policy capital receipts in FY16 were \$740m and comprise:

- Annuity sales of \$3,351m; less
- Annuity capital payments of \$2,611m.

Annuity capital payments are returns of capital to annuitants and exclude interest payments.

Annuity net book growth can be calculated as annuity net flows (\$740m) divided by the opening period Life annuity book (\$8,693m – refer to page 10). Annuity net book growth was 8.5% in FY16.

### Net other Life capital receipts

Net other Life capital receipts in FY16 were \$309m and comprise:

- Other Life sales of \$999m; less
- Other Life capital payments of \$690m.

Other Life sales benefited from a new \$300m Guaranteed Index Return (GIR) client mandate, received in the fourth quarter of FY16.

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

## Life financial results

| <b>\$m</b>                                                       | <b>FY16</b>   | <b>FY15</b>   | <b>FY14</b>   | <b>2H16</b>   | <b>1H16</b>   | <b>2H15</b>   | <b>1H15</b>   | <b>2H14</b>   | <b>1H14</b>   |
|------------------------------------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Investment yield – policyholders' funds                          | 767.5         | 765.8         | 740.2         | 385.1         | 382.4         | 390.2         | 375.6         | 365.7         | 374.5         |
| Interest expense                                                 | (410.4)       | (413.8)       | (397.0)       | (203.5)       | (206.9)       | (209.1)       | (204.7)       | (197.4)       | (199.6)       |
| Distribution expense                                             | (24.5)        | (25.5)        | (30.2)        | (14.3)        | (10.2)        | (11.5)        | (14.0)        | (15.0)        | (15.2)        |
| Other income <sup>1</sup>                                        | 24.4          | 19.8          | 10.7          | 12.8          | 11.6          | 10.8          | 9.0           | 9.9           | 0.8           |
| <b>Product cash margin</b>                                       | <b>357.0</b>  | <b>346.3</b>  | <b>323.7</b>  | <b>180.1</b>  | <b>176.9</b>  | <b>180.4</b>  | <b>165.9</b>  | <b>163.2</b>  | <b>160.5</b>  |
| Investment yield – shareholders' funds                           | 134.9         | 117.1         | 102.0         | 67.3          | 67.6          | 59.7          | 57.4          | 51.2          | 50.8          |
| <b>Cash earnings</b>                                             | <b>491.9</b>  | <b>463.4</b>  | <b>425.7</b>  | <b>247.4</b>  | <b>244.5</b>  | <b>240.1</b>  | <b>223.3</b>  | <b>214.4</b>  | <b>211.3</b>  |
| Normalised capital growth                                        | 100.5         | 80.4          | 55.6          | 52.1          | 48.4          | 45.9          | 34.5          | 29.7          | 25.9          |
| <b>Normalised Cash Operating Earnings (COE)</b>                  | <b>592.4</b>  | <b>543.8</b>  | <b>481.3</b>  | <b>299.5</b>  | <b>292.9</b>  | <b>286.0</b>  | <b>257.8</b>  | <b>244.1</b>  | <b>237.2</b>  |
| Personnel expenses                                               | (56.7)        | (51.0)        | (45.6)        | (29.8)        | (26.9)        | (25.6)        | (25.4)        | (24.3)        | (21.3)        |
| Other expenses                                                   | (35.9)        | (36.1)        | (31.5)        | (18.8)        | (17.1)        | (19.5)        | (16.6)        | (16.2)        | (15.3)        |
| <b>Total expenses</b>                                            | <b>(92.6)</b> | <b>(87.1)</b> | <b>(77.1)</b> | <b>(48.6)</b> | <b>(44.0)</b> | <b>(45.1)</b> | <b>(42.0)</b> | <b>(40.5)</b> | <b>(36.6)</b> |
| <b>Normalised EBIT</b>                                           | <b>499.8</b>  | <b>456.7</b>  | <b>404.2</b>  | <b>250.9</b>  | <b>248.9</b>  | <b>240.9</b>  | <b>215.8</b>  | <b>203.6</b>  | <b>200.6</b>  |
| Investment experience                                            | (68.4)        | (50.0)        | 18.2          | (111.4)       | 43.0          | (14.6)        | (35.4)        | 14.1          | 4.1           |
| <b>Net profit after investment experience before tax</b>         | <b>431.4</b>  | <b>406.7</b>  | <b>422.4</b>  | <b>139.5</b>  | <b>291.9</b>  | <b>226.3</b>  | <b>180.4</b>  | <b>217.7</b>  | <b>204.7</b>  |
| <b>Reconciliation of investment experience to capital growth</b> |               |               |               |               |               |               |               |               |               |
| Investment experience                                            | (68.4)        | (50.0)        | 18.2          | (111.4)       | 43.0          | (14.6)        | (35.4)        | 14.1          | 4.1           |
| Normalised capital growth                                        | 100.5         | 80.4          | 55.6          | 52.1          | 48.4          | 45.9          | 34.5          | 29.7          | 25.9          |
| <b>Capital growth</b>                                            | <b>32.1</b>   | <b>30.4</b>   | <b>73.8</b>   | <b>(59.3)</b> | <b>91.4</b>   | <b>31.3</b>   | <b>(0.9)</b>  | <b>43.8</b>   | <b>30.0</b>   |
| <b>Performance analysis</b>                                      |               |               |               |               |               |               |               |               |               |
| Cost to income ratio <sup>2</sup>                                | 15.6%         | 16.0%         | 16.0%         | 16.2%         | 15.0%         | 15.8%         | 16.3%         | 16.6%         | 15.4%         |
| Net assets – average <sup>3</sup>                                | 2,449         | 2,294         | 2,022         | 2,528         | 2,488         | 2,385         | 2,270         | 2,065         | 1,908         |
| Normalised ROE (pre-tax)                                         | 19.9%         | 19.9%         | 20.0%         | 20.0%         | 19.8%         | 20.4%         | 18.9%         | 19.9%         | 20.9%         |

1. Other income includes Accurium revenue and Life Risk revenue (premiums net of claims).

2. Cost to income calculated as total expenses divided by Normalised Cash Operating Earnings.

3. Net assets – average is calculated based on period opening and closing balances.

## Life financial results

| \$m                                                                     | FY16           | FY15           | FY14           | 2H16           | 1H16           | 2H15           | 1H15           | 2H14           | 1H14           |
|-------------------------------------------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>Sales</b>                                                            |                |                |                |                |                |                |                |                |                |
| Fixed Term sales                                                        | 2,769.8        | 2,273.2        | 2,185.7        | 1,357.4        | 1,412.4        | 1,017.6        | 1,255.6        | 998.9          | 1,186.8        |
| Lifetime sales                                                          | 581.4          | 479.9          | 613.1          | 352.7          | 228.7          | 160.7          | 319.2          | 342.9          | 270.2          |
| <b>Life annuity sales</b>                                               | <b>3,351.2</b> | <b>2,753.1</b> | <b>2,798.8</b> | <b>1,710.1</b> | <b>1,641.1</b> | <b>1,178.3</b> | <b>1,574.8</b> | <b>1,341.8</b> | <b>1,457.0</b> |
| Maturities and repayments <sup>1</sup>                                  | (2,610.8)      | (2,014.9)      | (1,911.7)      | (1,240.2)      | (1,370.6)      | (1,000.9)      | (1,014.0)      | (994.6)        | (917.1)        |
| <b>Life annuity net flows<sup>1</sup></b>                               | <b>740.4</b>   | <b>738.2</b>   | <b>887.1</b>   | <b>469.9</b>   | <b>270.5</b>   | <b>177.4</b>   | <b>560.8</b>   | <b>347.2</b>   | <b>539.9</b>   |
| Life annuity book                                                       | 9,558.5        | 8,692.6        | 7,824.3        | 9,558.5        | 8,868.4        | 8,692.6        | 8,573.1        | 7,824.3        | 7,617.2        |
| <b>Annuity net book growth<sup>1</sup></b>                              | <b>8.5%</b>    | <b>9.4%</b>    | <b>12.5%</b>   | <b>5.4%</b>    | <b>3.1%</b>    | <b>2.2%</b>    | <b>7.2%</b>    | <b>4.9%</b>    | <b>7.6%</b>    |
| <b>Other Life sales</b>                                                 |                |                |                |                |                |                |                |                |                |
| Other Life sales                                                        | 998.5          | 944.0          | 581.6          | 588.8          | 409.7          | 395.1          | 548.9          | 291.5          | 290.1          |
| Other maturities and repayments                                         | (670.6)        | (1,031.3)      | (1,292.6)      | (337.5)        | (333.1)        | (360.0)        | (671.3)        | (250.5)        | (1,042.1)      |
| <b>Other Life net flows</b>                                             | <b>327.9</b>   | <b>(87.3)</b>  | <b>(711.0)</b> | <b>251.3</b>   | <b>76.6</b>    | <b>35.1</b>    | <b>(122.4)</b> | <b>41.0</b>    | <b>(752.0)</b> |
| Guaranteed Index Return liabilities                                     | 1,315.5        | 944.7          | 1,072.4        | 1,315.5        | 1,035.1        | 944.7          | 954.8          | 1,072.4        | 1,000.3        |
| <b>Other Life net book growth<sup>1</sup></b>                           | <b>34.7%</b>   | <b>(8.1%)</b>  | <b>(40.6%)</b> | <b>26.6%</b>   | <b>8.1%</b>    | <b>3.2%</b>    | <b>(11.4%)</b> | <b>2.3%</b>    | <b>(42.9%)</b> |
| Total Life net flows <sup>1</sup>                                       | 1,068.3        | 650.9          | 176.1          | 721.2          | 347.1          | 212.5          | 438.4          | 388.2          | (212.1)        |
| Life annuity book and GIR liabilities                                   | 10,874.0       | 9,637.3        | 8,896.7        | 10,874.0       | 9,903.5        | 9,637.3        | 9,527.9        | 8,896.7        | 8,617.5        |
| <b>Total Life net book growth<sup>1,5</sup></b>                         | <b>11.1%</b>   | <b>7.3%</b>    | <b>2.0%</b>    | <b>7.5%</b>    | <b>3.6%</b>    | <b>2.4%</b>    | <b>4.9%</b>    | <b>4.4%</b>    | <b>(2.4%)</b>  |
| <b>Assets</b>                                                           |                |                |                |                |                |                |                |                |                |
| <b>Closing investment assets</b>                                        | <b>14,112</b>  | <b>12,795</b>  | <b>11,087</b>  | <b>14,112</b>  | <b>13,147</b>  | <b>12,795</b>  | <b>12,393</b>  | <b>11,087</b>  | <b>10,889</b>  |
| Fixed income and cash <sup>2</sup>                                      | 8,473          | 8,394          | 7,935          | 8,537          | 8,409          | 8,575          | 8,234          | 7,911          | 7,964          |
| Property                                                                | 3,178          | 2,640          | 1,953          | 3,220          | 3,120          | 2,906          | 2,385          | 2,036          | 1,870          |
| Equity and other investments                                            | 988            | 626            | 394            | 1,059          | 928            | 742            | 511            | 423            | 371            |
| Infrastructure                                                          | 550            | 516            | 518            | 553            | 545            | 518            | 512            | 533            | 504            |
| <b>Average investment assets<sup>3</sup></b>                            | <b>13,189</b>  | <b>12,176</b>  | <b>10,800</b>  | <b>13,369</b>  | <b>13,002</b>  | <b>12,741</b>  | <b>11,642</b>  | <b>10,903</b>  | <b>10,709</b>  |
| <b>Liabilities</b>                                                      |                |                |                |                |                |                |                |                |                |
| <b>Closing liabilities – annuities, GIR, capital notes and sub debt</b> | <b>11,796</b>  | <b>10,550</b>  | <b>9,425</b>   | <b>11,796</b>  | <b>10,825</b>  | <b>10,550</b>  | <b>10,436</b>  | <b>9,425</b>   | <b>9,127</b>   |
| Average liabilities – annuities and GIR                                 | 9,981          | 9,397          | 8,675          | 10,166         | 9,786          | 9,706          | 9,107          | 8,617          | 8,623          |
| Average liabilities – capital notes                                     | 345            | 239            | –              | 345            | 345            | 345            | 148            | –              | –              |
| Average liabilities – sub debt                                          | 579            | 563            | 518            | 574            | 584            | 582            | 543            | 525            | 509            |
| <b>Average liabilities<sup>3</sup></b>                                  | <b>10,905</b>  | <b>10,199</b>  | <b>9,193</b>   | <b>11,085</b>  | <b>10,715</b>  | <b>10,633</b>  | <b>9,798</b>   | <b>9,142</b>   | <b>9,132</b>   |
| <b>Margins<sup>4</sup></b>                                              |                |                |                |                |                |                |                |                |                |
| Investment yield – policyholders' funds                                 | 5.8%           | 6.3%           | 6.9%           | 5.8%           | 5.9%           | 6.2%           | 6.4%           | 6.8%           | 7.0%           |
| Interest expenses                                                       | (3.1%)         | (3.4%)         | (3.7%)         | (3.1%)         | (3.2%)         | (3.3%)         | (3.5%)         | (3.7%)         | (3.7%)         |
| Distribution expense                                                    | (0.2%)         | (0.2%)         | (0.3%)         | (0.2%)         | (0.2%)         | (0.2%)         | (0.3%)         | (0.3%)         | (0.3%)         |
| Other income                                                            | 0.2%           | 0.2%           | 0.1%           | 0.2%           | 0.2%           | 0.2%           | 0.2%           | 0.2%           | –              |
| <b>Product cash margin</b>                                              | <b>2.7%</b>    | <b>2.9%</b>    | <b>3.0%</b>    | <b>2.7%</b>    | <b>2.7%</b>    | <b>2.9%</b>    | <b>2.8%</b>    | <b>3.0%</b>    | <b>3.0%</b>    |
| Investment yield – shareholders' funds                                  | 1.0%           | 0.9%           | 1.0%           | 1.0%           | 1.0%           | 0.9%           | 1.0%           | 1.0%           | 0.9%           |
| <b>Cash earnings</b>                                                    | <b>3.7%</b>    | <b>3.8%</b>    | <b>4.0%</b>    | <b>3.7%</b>    | <b>3.7%</b>    | <b>3.8%</b>    | <b>3.8%</b>    | <b>4.0%</b>    | <b>3.9%</b>    |
| Normalised capital growth                                               | 0.8%           | 0.7%           | 0.5%           | 0.8%           | 0.8%           | 0.7%           | 0.6%           | 0.5%           | 0.5%           |
| <b>Normalised Cash Operating Earnings (COE)</b>                         | <b>4.5%</b>    | <b>4.5%</b>    | <b>4.5%</b>    | <b>4.5%</b>    | <b>4.5%</b>    | <b>4.5%</b>    | <b>4.4%</b>    | <b>4.5%</b>    | <b>4.4%</b>    |

1. 2H14 and FY14 maturities and repayments, Life annuity net flows and annuity net book growth excludes maturity of the High Yield Fund annuity (\$284m).

2. Includes NIM (FY16: \$120m, FY15: \$156m, FY14: \$202m).

3. Average investment assets and average liabilities are calculated on a monthly basis.

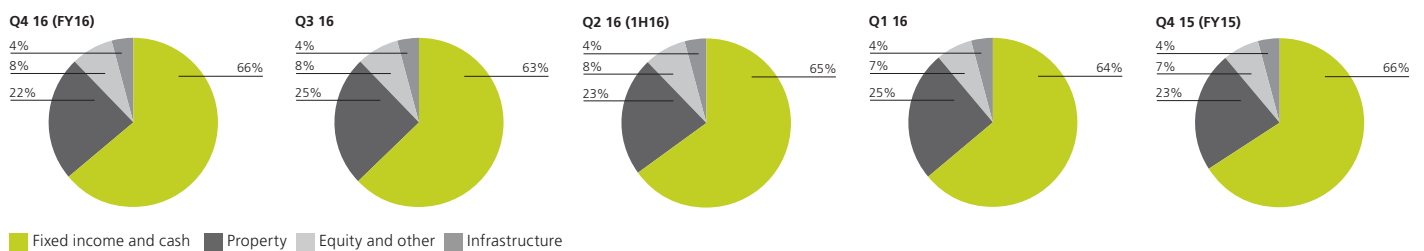
4. Ratio of Normalised Cash Operating Earnings components divided by average investment assets.

5. Total Life net book growth represents Life annuity net flows and other Life net flows over the period divided by the opening Life annuity book and Guaranteed Index Return liabilities.

## Life quarterly sales and investment assets

| \$m                                               | Q4 16         | Q3 16         | Q2 16         | Q1 16         | Q4 15         |
|---------------------------------------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Life sales</b>                                 |               |               |               |               |               |
| Fixed Term                                        | 912           | 445           | 801           | 611           | 652           |
| Lifetime (including Care)                         | 223           | 130           | 133           | 96            | 81            |
| <b>Total annuity sales</b>                        | <b>1,135</b>  | <b>575</b>    | <b>934</b>    | <b>707</b>    | <b>733</b>    |
| Other Life sales                                  | 300           | 289           | 233           | 177           | -             |
| <b>Total Life sales</b>                           | <b>1,435</b>  | <b>864</b>    | <b>1,167</b>  | <b>884</b>    | <b>733</b>    |
| <b>Life</b>                                       |               |               |               |               |               |
| Fixed income and cash <sup>1</sup>                | 9,316         | 8,280         | 8,488         | 8,336         | 8,514         |
| Property <sup>1</sup>                             | 3,150         | 3,243         | 3,063         | 3,218         | 2,884         |
| Equity and other                                  | 1,079         | 1,042         | 1,060         | 909           | 883           |
| Infrastructure <sup>1</sup>                       | 567           | 537           | 536           | 558           | 514           |
| <b>Total Life investment assets</b>               | <b>14,112</b> | <b>13,102</b> | <b>13,147</b> | <b>13,021</b> | <b>12,795</b> |
| <b>Average Life investment assets<sup>2</sup></b> | <b>13,535</b> | <b>13,134</b> | <b>13,047</b> | <b>12,962</b> | <b>12,857</b> |

### Life asset allocation



1. Fixed income, property and infrastructure reported net of debt.  
 2. Average Life investment assets calculated on a monthly basis.

## Life financial results

Challenger Life Company (CLC) is Australia's leading provider of annuities and guaranteed retirement income products. These 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 within the major hubs. Being an independent product manufacturer, CLC's products are included on all major hub approved product lists (APLs).

CLC has won the Association of Financial Advisers/Plan for Life 'Annuity Provider of the Year' for the past eight years.

The Life business also includes Accurium, Australia's leading provider of Self-Managed Superannuation Fund (SMSF) actuarial certificates and has been repositioned by Challenger as an SMSF retirement specialist (refer to page 16 for additional detail).

CLC is diversifying its capital and earnings base by participating in wholesale reinsurance longevity and mortality transactions (Life Risk). Life is experienced in managing, pricing and reinsuring longevity and mortality risk. Refer to page 16 for additional details on Life Risk.

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 are disclosed on page 29.

### Normalised EBIT and ROE

Life FY16 normalised EBIT was \$500m and increased by \$43m (9%) for the year. The increase in EBIT reflects a \$48m increase in normalised cash operating earnings, partly offset by a \$6m increase in expenses.

FY16 Life ROE (pre-tax) was 19.9% and was unchanged from FY15, with the increase in Life EBIT offset by higher net assets.

Challenger targets an 18% (pre-tax) ROE and expects to continue to meet this target over both the medium and long term.

### Normalised Cash Operating Earnings (COE) and COE margin

FY16 normalised COE was \$592m and increased by \$48m (9%) for the year. The increase in normalised COE is a result of higher average AUM, which increased by 8% and a stable Life COE margin.

Life's FY16 COE margin was 4.5% and is unchanged from FY15. The FY16 Life COE margin includes the following components:

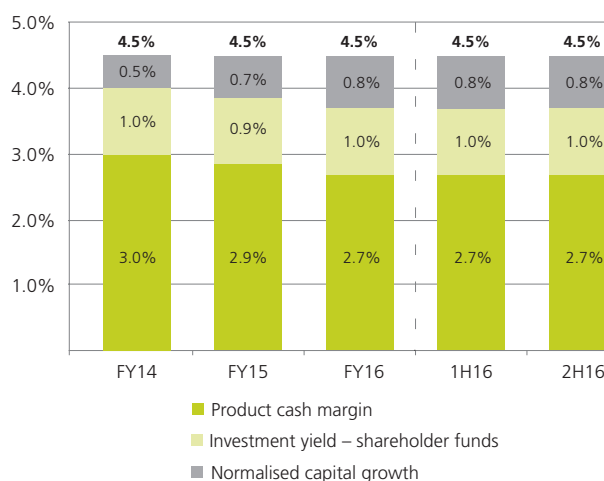
- Product cash margin of 2.7% – down 0.2% on FY15 due to lower asset returns, partially offset by lower annuity funding rates. Product cash margin includes a contribution from Accurium and Life Risk of 0.2% (FY15 0.2%);
- Return on shareholder funds of 1.0% – up 0.1% on FY15 due to higher average shareholder capital, partially offset by lower investment returns. Investment returns on shareholder capital reduced due to the lower interest rate environment, with shareholder capital not hedged for movements in interest rates; and
- Normalised capital growth of 0.8% – up 0.1% on FY15 due to higher property and equity investment allocations during the year, partially offset by a lower equities normalised growth assumption (refer to page 42 for more detail).

FY16 normalised COE includes other income of \$24m, which was \$4m higher than in FY15. Other income includes Accurium revenue of \$9m (FY15 \$10m) and Life Risk of \$15m (FY15 \$10m). Life Risk represents premiums net of expected claims on wholesale reinsurance longevity and mortality transactions (refer to page 16 for more detail).

Life's COE margin in 2H16 was 4.5%, and was unchanged from 1H16, with lower asset yields (down 10 bps) fully offset by a reduction in annuity funding cost (down 10 bps).

Life's COE margin has been in the range of 4.4% and 4.5% for the last eight consecutive half year periods (since 1H13).

### Life COE margin composition



## Expenses

FY16 total expenses were \$93m, up \$6m (6%) on FY15. Life expenses increased as a result of higher employee numbers, with employees added across IT and operations to support Life's new distribution initiatives, including annuities on platform.

Despite the increase in FY16 expenses, Life's cost to income ratio fell by 40 bps on FY15 to 15.6% in FY16.

2H16 Life expenses were \$49m, an increase of \$5m on 1H16. The increase in 2H16 reflects phased increase of personnel costs associated with resources supporting the Life business, and timing of technology and marketing spend associated with the launch of Challenger's new Lifestyle expectancy advertising campaign in February 2016.

## Investment experience overview

Challenger Life is required by Australian accounting standards to value investment assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on investment 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 42 for details on Challenger's assumed long term expected returns by asset class.

Investment experience also includes any impact from changes in economic variables and assumptions, including changes in discount rates used to value Life's liabilities (refer to page 43 for more detail).

FY16 investment experience was a \$68m loss (pre-tax), comprising a \$139m loss on Life's investment assets and a \$71m gain on Life's annuity liabilities.

| <b>Asset class (\$m)</b>           | <b>Actual capital growth</b> | <b>Normalised capital growth</b> | <b>Investment experience</b> |
|------------------------------------|------------------------------|----------------------------------|------------------------------|
| Fixed income                       | (139)                        | (29)                             | (110)                        |
| Property                           | 115                          | 64                               | 51                           |
| Infrastructure                     | 29                           | 22                               | 7                            |
| Equity and other                   | (43)                         | 44                               | (87)                         |
| <b>Asset investment experience</b> | <b>(38)</b>                  | <b>101</b>                       | <b>(139)</b>                 |
| Annuity valuation experience       | 71                           | –                                | 71                           |
| <b>Total investment experience</b> | <b>33</b>                    | <b>101</b>                       | <b>(68)</b>                  |



## Asset investment experience

The FY16 loss on Life's investment assets (\$139m) was primarily due to:

- losses on Life's fixed income portfolio (-\$110m) including unrealised mark to market losses due to expansion in domestic and offshore credit spreads.

As Challenger is generally a hold to maturity investor, any unrealised revaluation of Challenger's fixed income portfolio is expected to reverse over time. The FY16 fixed income portfolio unrealised losses reflected an expansion in both domestic and offshore credit spreads. For example, A-rated 3 year credit spreads<sup>1</sup> increased by 30 bps and BBB-rated 3 year credit spreads<sup>1</sup> increased by 76 bps in FY16, and United Kingdom credit spreads expanded significantly more due to market uncertainty from the Brexit vote in late June 2016.

Included in Life's fixed income portfolio loss was an allowance for credit default losses of \$26m (FY15 -\$24m) or 31 bps (FY15 -26 bps).

- strong property valuation gains (+\$51m), which include both unrealised market movements and realised gains following the disposal of a number of properties as part of Life's property portfolio remix. Direct property valuations increased by 4% (excluding \$47m of property transaction costs from recent acquisitions) during FY16 and properties disposed of were at an average premium to book value of 12%;
- gains on infrastructure (+\$7m); and
- losses on Life's equity portfolio (-\$87m) as a result of equity market volatility.

## Annuity valuation investment experience

Investment experience includes the impact of changes in macroeconomic variables on the valuation of Challenger Life's policy liabilities. Economic and actuarial assumption changes include changes to bond yields and expected inflation rates, expense assumptions, losses on new business and other factors.

The FY16 gain on Life's annuity liabilities (\$71m) was due to changes in economic variables and assumptions, and primarily relate to:

- a higher illiquidity premium used to value Life's annuity liabilities resulting in a gain of \$62m – refer below;
- positive longevity experience (gain of \$26m) following completion of an actuarial mortality review of Liquid Lifetime during the period; and
- other assumption changes (gain of \$26m), including lower unit costs and CPI assumptions; offset by
- net new business loss of \$43m.

## Illiquidity premium

In accordance with Prudential Standards and Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium.

Movements in credit spreads impact the fair value of assets as well as the illiquidity premium which forms part of the discount rate for policy liabilities.

The illiquidity premium that is included for policy liabilities is calculated in accordance with APRA's prudential standard LPS 112 Capital Adequacy: Measurement of Capital, AASB 1038 Life Insurance Contracts and AASB 139 Financial Instruments: Recognition and Measurement.

## New business loss

In accordance with Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium. Life tends to offer annuity rates which are higher than these rates. As a result, on writing new annuity business, a loss is recognised when issuing the annuity contract due to a lower discount rate used to value the annuity liability. This loss is a non-cash item and unwinds over the period of the annuity contract.

The new business loss and subsequent unwind is reported in the profit and loss and disclosed as part of annuity valuation experience in investment experience.

1. RBA non-financial corporate A-rated bonds and non-financial corporate BBB-rated bonds – spread to swap – 3 year target tenor.

## Sales and AUM

### Annuity sales

FY16 Life annuity sales were \$3.4bn, and increased by 22% on FY15. Term annuity sales increased by 22% and lifetime annuity sales increased by 21%.

Both term and lifetime annuity sales continue to benefit from favourable demographic trends, including an ageing population and retirees taking a more conservative approach to retirement investing. These favourable demographic trends are being leveraged by Challenger's market leading retirement income brand, highly rated distribution team and product innovation capability.

Challenger's annuity sales growth is also benefiting from new distribution partnerships and initiatives. During FY16, Challenger's annuities were launched on the Colonial First State platform, Australia's leading investment platform which provides access to half of Australia's financial adviser firms. In the industry fund segment, Challenger backed term and lifetime annuities have been integrated with VicSuper account-based pensions to effectively create Australia's first Comprehensive Income Product for Retirement (CIPR), and a partnership with the Link Group has been formed. Link Group services the needs of ten million industry superannuation member accounts. With the technology build completed during late FY16, the Link Group can now offer Challenger annuities to industry fund members using Link's administration platform.

FY16 annuity sales from these new platform initiatives were in excess of \$200m, and represented approximately 6% of Life's total annuity sales. Approximately 30% of these new platform sales were lifetime annuities (1H16 22%; 2H16 40%).

Lifetime annuity sales of \$581m in FY16 represent 17% of total FY16 annuity sales, which was unchanged from FY15. In 2H16, lifetime sales represented 21% of total 2H16 annuity sales, up from 14% in 1H16 with strong growth in Liquid Lifetime and CarePlus sales (refer below). 2H16 Liquid Lifetime sales of \$306m, represented a record half yearly result and increased 42% on 1H16. Liquid Lifetime sales are benefiting from the move to retirement income model portfolios, which allocate a portion of retiree savings to lifetime annuities.

During FY16, Challenger launched a new lifetime annuity, designed specifically for the aged care market (CarePlus). During 1H16 CarePlus was added to the APLs of the major hubs, and Challenger focused on educating financial advisers on product features and how CarePlus could benefit their aged care clients. CarePlus sales were \$14m in 1H16, and \$46m in 2H16 with significant growth in the last quarter (Q416 CarePlus sales \$32m). Further growth in CarePlus sales is expected in FY17 with CarePlus scheduled to be included on the Colonial First State platforms in Q117.

As a result of an increasing proportion of sales being lifetime annuities, new business tenor is increasing. FY16 new business tenor was 6.5 years, up from 6.4 years in FY15, and 2H16 new business tenor was 7.2 years, up from 5.6 years in 1H16.

### Other Life sales

FY16 other Life sales represent Challenger's Guaranteed Index Return (GIR) product, and increased by 6% to \$999m in FY16. The \$999m of sales in FY16 includes a new GIR client mandate of \$300m received in Q416 with the balance of sales being reinvestment of distributions and maturities.

### Net book growth

#### Life annuity net book growth

FY16 Life annuity net flows (i.e. annuity sales less capital repayments) were \$740m. Based on the closing FY15 Life annuity book (\$8,693m), FY16 annuity net book growth was 8.5%.

#### Other Life net book growth

FY16 other Life net flows (i.e. sales less capital repayments) were \$328m. Based on the closing FY15 GIR liability (\$945m), FY16 other Life net book growth was 34.7%.

#### Total Life net book growth

FY16 total Life net flows across both annuities and other products (i.e. GIR) was \$1,068m, including annuity net flows of \$740m and other net flows of \$328m. Based on the closing FY15 annuity liability (\$8,693m) and GIR liability (\$945m), FY16 total Life net book growth was 11.1%, up from 7.3% in FY15.

### Average AUM

Life's FY16 average investment assets were \$13.2bn, and increased by 8% (\$1.0bn) on FY15. The increase in average investment assets is due to Life earnings (net of dividends to Group), annuity net flows and growth in the GIR product.

## Accurium

Accurium is Australia's leading provider of Self-Managed Superannuation Fund (SMSF) actuarial certificates. An actuarial certificate is required by a SMSF when one (or more) members are in the retirement phase of superannuation and one (or more) are in the savings phase of superannuation. Accurium has approximately 55% market share of the SMSF actuarial certificate market.

Accurium's vision is to become Australia's SMSF retirement specialist and leverage existing relationships with SMSF practitioners to increase the level of engagement and education for SMSF retirement solutions.

During FY15, Accurium has launched a SMSF Retirement Healthcheck in order to help build an understanding of the sustainability of retirement spending and retirement issues, including life expectancy, market performance and inflation. The Healthcheck has been rolled out to Accurium clients with approximately 33,000 Healthchecks undertaken since launch.

In conjunction with The University of Adelaide, Accurium launched a SMSF Retirement Essentials Course during FY16. The SMSF Retirement Essentials Course is aimed at helping educate SMSF practitioners on the differences between the accumulation and the retirement phase of superannuation and

the additional risks retirees face. Accurium's FY16 revenue was \$9m, down \$1m on FY15. Accurium's revenue is included in other income under Life's normalised profit framework.

## Life Risk

FY16 Life COE includes \$15m of income as a result of Life Risk transactions, up from \$10m in FY15. Life Risk income represents premiums net of expected claims.

As at 30 June 2016, the present value of future profits arising from Life Risk transactions undertaken was \$243m, up from \$181m in FY15 and broadly unchanged from 1H16.

The present value of future profits arising from Life Risk transactions represents the present value of expected future cash inflows (premiums) and cash outflows (claims). The present value of expected future cash flows increased by \$62m in FY16, following the execution of a longevity swap transaction in 1H16. No Life risk transactions were completed in 2H16.

The Life Risk portfolio has an average duration of 15 years.

Undertaking wholesale longevity and mortality transactions is a natural business extension for Life. Life is participating in established markets, has specialised expertise and is taking a disciplined approach to the wholesale Life Risk opportunity.

## Life balance sheet

| \$m                                       | FY16            | 1H16            | FY15            | 1H15            | FY14            | 1H14            |
|-------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| <b>Assets</b>                             |                 |                 |                 |                 |                 |                 |
| <b>Life investment assets</b>             |                 |                 |                 |                 |                 |                 |
| Cash and equivalents                      | 1,990.6         | 1,631.9         | 728.4           | 1,307.3         | 1,243.7         | 1,331.5         |
| Asset backed securities                   | 4,138.1         | 4,044.5         | 4,340.6         | 4,209.5         | 3,565.9         | 3,576.4         |
| Corporate credit                          | 3,186.8         | 2,811.2         | 3,444.7         | 3,024.3         | 3,146.1         | 3,075.3         |
| <b>Fixed income and cash (net)</b>        | <b>9,315.5</b>  | <b>8,487.6</b>  | <b>8,513.7</b>  | <b>8,541.1</b>  | <b>7,955.7</b>  | <b>7,983.2</b>  |
| Australian – Office                       | 1,498.4         | 1,385.2         | 1,359.0         | 1,138.2         | 805.5           | 657.6           |
| Australian – Retail                       | 962.0           | 986.1           | 818.0           | 721.6           | 480.3           | 437.4           |
| Australian – Industrial                   | 188.3           | 98.6            | 96.7            | 162.8           | 165.1           | 134.6           |
| Japanese                                  | 242.4           | 203.6           | 225.1           | 204.3           | 203.4           | 233.9           |
| REITS and other <sup>1</sup>              | 258.9           | 389.7           | 384.9           | 489.5           | 513.5           | 488.5           |
| <b>Property (net)</b>                     | <b>3,150.0</b>  | <b>3,063.2</b>  | <b>2,883.7</b>  | <b>2,716.4</b>  | <b>2,167.8</b>  | <b>1,952.0</b>  |
| Equity and other investments              | 1,079.0         | 1,060.0         | 882.8           | 632.4           | 400.7           | 433.1           |
| Infrastructure (net)                      | 567.2           | 536.4           | 514.4           | 503.0           | 563.2           | 520.9           |
| <b>Life investment assets</b>             | <b>14,111.7</b> | <b>13,147.2</b> | <b>12,794.6</b> | <b>12,392.9</b> | <b>11,087.4</b> | <b>10,889.2</b> |
| Other assets (including intangibles)      | 516.0           | 460.1           | 456.4           | 601.4           | 659.1           | 490.4           |
| <b>Total assets</b>                       | <b>14,627.7</b> | <b>13,607.3</b> | <b>13,251.0</b> | <b>12,994.3</b> | <b>11,746.5</b> | <b>11,379.6</b> |
| Life annuity book                         | 9,558.5         | 8,868.4         | 8,693.0         | 8,573.1         | 7,824.3         | 7,617.2         |
| Guaranteed Index Return (GIR) liabilities | 1,315.5         | 1,035.1         | 944.7           | 954.8           | 1,072.4         | 1,000.3         |
| Subordinated debt                         | 576.7           | 576.5           | 567.0           | 560.7           | 525.9           | 509.5           |
| Challenger Capital Notes                  | 345.0           | 345.0           | 345.0           | 345.0           | –               | –               |
| Other liabilities                         | 342.6           | 215.2           | 292.3           | 199.8           | 144.8           | 301.2           |
| <b>Total liabilities</b>                  | <b>12,138.3</b> | <b>11,040.2</b> | <b>10,842.0</b> | <b>10,633.4</b> | <b>9,567.4</b>  | <b>9,428.2</b>  |
| <b>Net assets</b>                         | <b>2,489.4</b>  | <b>2,567.1</b>  | <b>2,409.0</b>  | <b>2,360.9</b>  | <b>2,179.1</b>  | <b>1,951.4</b>  |

## Challenger Life Company (CLC) debt facilities

| \$m                              | FY16           | 1H16           | FY15           | 1H15           | FY14           | 1H14           |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Controlled property debt         | 572.9          | 652.9          | 566.1          | 679.2          | 721.4          | 823.1          |
| Subordinated debt                | 576.7          | 576.5          | 567.0          | 560.7          | 525.9          | 509.5          |
| Repurchase agreements            | 2,454.2        | 1,875.1        | 1,267.3        | 1,163.3        | 978.3          | 729.2          |
| Infrastructure debt              | 204.3          | 206.0          | 206.0          | 205.0          | 206.1          | 206.1          |
| Other finance                    | 18.8           | 19.5           | 1.4            | 3.3            | 3.2            | 103.8          |
| <b>Total CLC debt facilities</b> | <b>3,826.9</b> | <b>3,330.0</b> | <b>2,607.8</b> | <b>2,611.5</b> | <b>2,434.9</b> | <b>2,371.7</b> |

1. REITS and other includes listed Australian REITS (FY16 nil), unlisted Australian REITS and European directly held properties.

## Life balance sheet

Life maintains a high quality investment portfolio in order to generate cash flows to meet future annuity obligations.

### Life investment assets

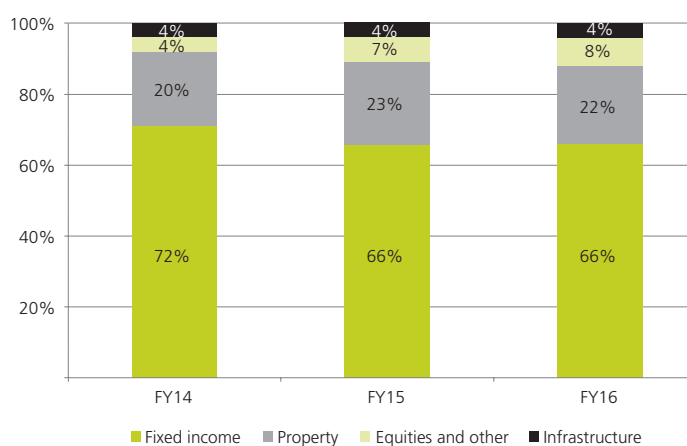
Life's investment asset allocation reflects both the relative value of different asset classes and the tenor of annuity sales as Life maintains a cash flow matched portfolio.

Life's investment assets at 30 June 2016 comprised:

- Fixed income and cash 66%;
- Property 22%;
- Equities and other investments 8%; and
- Infrastructure 4%.

### Life investment portfolio overview chart

Detailed disclosure on Life's investment assets is included on pages 19 to 28.



### CLC debt facilities

CLC debt facilities includes debt which is non-recourse to the Challenger Group and is secured against assets held in investment vehicles by CLC, including direct properties and infrastructure investments. CLC debt facilities increased by \$1.2bn during FY16, as a result of an increase in repurchase agreements used to hedge for interest rate movements.

### Repurchase agreements

CLC enters into repurchase agreements whereby fixed income securities are sold for cash whilst simultaneously agreeing to repurchase the fixed income security at a fixed price and fixed date in the future. The use of repurchase agreements is part of Challenger's strategy to hedge interest rate movements.

CLC uses Australian Commonwealth Government Bonds (ACGBs) and repurchase agreements, interest rate swaps and bond futures to hedge for movements in interest rates on its asset portfolio, annuity policy liabilities and Guaranteed Index Return mandates. During FY16, swap spreads, being the difference in yield between interest rate swaps and ACGBs, fell approximately 15 bps to historical lows. As a result, bonds provided a more cost effective hedge than swaps and so CLC's holding in ACGBs (net of repurchase agreements) increased by \$1.1bn in FY16.

Derivatives such as interest rate swaps and bond futures are self-financing, whereas the use of bonds requires the use of repurchase agreement financing. As a consequence, outstanding repurchase agreements as at 30 June 2016 increased by \$1.2bn to \$2.5bn.

## 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 maintains a cash flow matched portfolio.

Life's investment assets at 30 June 2016 comprised:

- Fixed income and cash 66%;
- Property 22%;
- Equities and other investments 8%; and
- Infrastructure 4%.

### Fixed income portfolio overview

Life's fixed income and cash portfolio was \$9.3bn (net of debt) at 30 June 2016 up from \$8.5bn at 30 June 2015. Fixed income and cash represented 66% of Life's total investment assets and was unchanged from 30 June 2015.

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.

Life's liabilities and cash flows are long-term in nature and contracted. This provides the opportunity to invest in long-dated and illiquid fixed income investments, allowing Life to earn an illiquidity premium on fixed income investments. The average fixed income illiquidity premium generated over the last five years has averaged between 1% and 2%.

The fixed income portfolio comprises over 1,100 different securities with 81% of the fixed income portfolio investment grade (i.e. BBB or higher), up from 76% at 30 June 2015.

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 the 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 73% of the total fixed income portfolio.

Approximately 25% of Life's fixed income portfolio represents fixed income investments that have been originated by Challenger. Direct fixed income origination includes senior secured loans, asset backed securities and commercial real estate lending. Life's direct origination capability has been in place for over ten years and provides opportunities to capture relative value including illiquidity premiums as Life is generally a hold-to-maturity investor. The proportion of Life's fixed income investments directly originated by Challenger is expected to remain ~25% of the total fixed income portfolio.

### Credit defaults

The credit default allowance recognised in the profit and loss in FY16 was -\$26m or -31 bps (FY15 -\$24m or -26 bps) and relates to six individual credit exposures. The overall fixed income portfolio is highly diversified and continues to generate high quality cash flows.

Over the past five years average credit default allowance recognised in the profit and loss was -13bps.

Detailed disclosure of Life's fixed income portfolio is included on pages 20 to 23. The fixed income disclosures include the following tables.

1. Table 1 – fixed income portfolio overview;
2. Table 2 – fixed income portfolio by credit rating;
3. Table 3 – fixed income portfolio by rating type;
4. Table 4 – fixed income portfolio by industry sector; and
5. Table 5 – fixed income portfolio by geography and credit rating.

**Table 1: Fixed income portfolio overview**

| <b>30 June 2016</b>                  |                           | <b>\$m</b>   | <b>% portfolio</b> |                                                                                                                                                                                                                        |
|--------------------------------------|---------------------------|--------------|--------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Liquids</b>                       |                           | 1,991        | 21%                | Includes cash and equivalents and Government Bonds.                                                                                                                                                                    |
|                                      | RMBS                      | 1,928        | 21%                | Residential mortgage backed securities (RMBS). RMBS expertise developed when Challenger was Australia's largest non-bank securitiser of RMBS (via Mortgage Management business sold in 2009). Also includes NIM notes. |
| <b>Asset Backed Securities (ABS)</b> | Other ABS                 | 942          | 10%                | Financing secured against underlying assets. Asset security includes motor vehicle, equipment and consumer finance.                                                                                                    |
|                                      | Senior Secured Bank Loans | 756          | 8%                 | Senior debt secured by collateral and typically originated by Challenger.                                                                                                                                              |
|                                      | Aviation Finance          | 275          | 3%                 | Secured commercial aircraft financing.                                                                                                                                                                                 |
|                                      | CMBS                      | 237          | 2%                 | Commercial Mortgage Backed Securities (CMBS).                                                                                                                                                                          |
|                                      | Banks & Financials        | 1,090        | 12%                | Corporate loans to banks, insurance companies and fund managers.                                                                                                                                                       |
|                                      | Infrastructure            | 785          | 8%                 | Long dated inflation linked bonds issued by Public Private Partnership projects and loans to infrastructure companies.                                                                                                 |
| <b>Corporate Credit</b>              | Non-Financial Corporates  | 698          | 7%                 | Traded commercial loans to industrials and retailers.                                                                                                                                                                  |
|                                      | Commercial Real Estate    | 614          | 8%                 | Loans secured against commercial real estate assets and typically originated by Challenger.                                                                                                                            |
| <b>Total</b>                         |                           | <b>9,316</b> | <b>100%</b>        |                                                                                                                                                                                                                        |



Table 2: Fixed income portfolio by credit rating

| 30 June 2016 (\$m)                   | Investment grade |              |            |              |              |              | Non-investment grade |            |              | Total        |
|--------------------------------------|------------------|--------------|------------|--------------|--------------|--------------|----------------------|------------|--------------|--------------|
|                                      | Liquids          | AAA          | AA         | A            | BBB          | Total        | BB                   | B or lower | Total        | \$m          |
| <b>Liquids</b>                       |                  |              |            |              |              |              |                      |            |              |              |
| Government Bonds                     | 1,561            | –            | –          | –            | –            | <b>1,561</b> | –                    | –          | –            | <b>1,561</b> |
| Cash & equivalents                   | 430              | –            | –          | –            | –            | <b>430</b>   | –                    | –          | –            | <b>430</b>   |
| <b>Asset Backed Securities (ABS)</b> |                  |              |            |              |              |              |                      |            |              |              |
| RMBS                                 | –                | 757          | 380        | 266          | 285          | <b>1,688</b> | 85                   | 155        | <b>240</b>   | <b>1,928</b> |
| Other ABS                            | –                | 105          | 87         | 170          | 144          | <b>506</b>   | 284                  | 152        | <b>436</b>   | <b>942</b>   |
| Senior Secured Loans                 | –                | 242          | 16         | 122          | 261          | <b>641</b>   | 94                   | 21         | <b>115</b>   | <b>756</b>   |
| Aviation Finance                     | –                | –            | –          | 42           | 105          | <b>147</b>   | 57                   | 71         | <b>128</b>   | <b>275</b>   |
| CMBS                                 | –                | 7            | –          | 28           | 39           | <b>74</b>    | 136                  | 27         | <b>163</b>   | <b>237</b>   |
| <b>Corporate credit</b>              |                  |              |            |              |              |              |                      |            |              |              |
| Banks & Financials                   | –                | –            | 64         | 458          | 533          | <b>1,055</b> | 35                   | –          | <b>35</b>    | <b>1,090</b> |
| Infrastructure                       | –                | 7            | 150        | 117          | 437          | <b>711</b>   | 54                   | 20         | <b>74</b>    | <b>785</b>   |
| Non-financial Corporates             | –                | –            | –          | 106          | 157          | <b>263</b>   | 353                  | 82         | <b>435</b>   | <b>698</b>   |
| Commercial Real Estate               | –                | 29           | 16         | 123          | 300          | <b>468</b>   | 116                  | 30         | <b>146</b>   | <b>614</b>   |
| <b>Total</b>                         | <b>1,991</b>     | <b>1,147</b> | <b>713</b> | <b>1,432</b> | <b>2,261</b> | <b>7,544</b> | <b>1,214</b>         | <b>558</b> | <b>1,772</b> | <b>9,316</b> |
| Fixed income portfolio %             | 21%              | 12%          | 8%         | 15%          | 25%          | <b>81%</b>   | 13%                  | 6%         | <b>19%</b>   | <b>100%</b>  |
| Average duration (years)             | 0.0              | 2.1          | 3.7        | 2.4          | 3.4          | <b>2.9</b>   | 3.3                  | 2.8        | <b>3.1</b>   | <b>3.0</b>   |

| 30 June 2016 (%)                     | Investment grade |            |           |            |            |             | Non-investment grade |            |            | Total       |
|--------------------------------------|------------------|------------|-----------|------------|------------|-------------|----------------------|------------|------------|-------------|
|                                      | Liquids          | AAA        | AA        | A          | BBB        | Total       | BB                   | B or lower | Total      | %           |
| <b>Liquids</b>                       |                  |            |           |            |            |             |                      |            |            |             |
| Government Bonds                     | 100%             | –          | –         | –          | –          | <b>100%</b> | –                    | –          | –          | <b>100%</b> |
| Cash & equivalents                   | 100%             | –          | –         | –          | –          | <b>100%</b> | –                    | –          | –          | <b>100%</b> |
| <b>Asset Backed Securities (ABS)</b> |                  |            |           |            |            |             |                      |            |            |             |
| RMBS                                 | –                | 39%        | 20%       | 14%        | 15%        | <b>88%</b>  | 4%                   | 8%         | <b>12%</b> | <b>100%</b> |
| Other ABS                            | –                | 11%        | 9%        | 18%        | 16%        | <b>54%</b>  | 30%                  | 16%        | <b>46%</b> | <b>100%</b> |
| Senior Secured Loans                 | –                | 32%        | 2%        | 16%        | 35%        | <b>85%</b>  | 12%                  | 3%         | <b>15%</b> | <b>100%</b> |
| Aviation Finance                     | –                | –          | –         | 15%        | 38%        | <b>53%</b>  | 21%                  | 26%        | <b>47%</b> | <b>100%</b> |
| CMBS                                 | –                | 3%         | –         | 12%        | 16%        | <b>31%</b>  | 57%                  | 12%        | <b>69%</b> | <b>100%</b> |
| <b>Corporate credit</b>              |                  |            |           |            |            |             |                      |            |            |             |
| Banks & Financials                   | –                | –          | 6%        | 42%        | 49%        | <b>97%</b>  | 3%                   | –          | <b>3%</b>  | <b>100%</b> |
| Infrastructure                       | –                | 1%         | 19%       | 15%        | 56%        | <b>91%</b>  | 7%                   | 2%         | <b>9%</b>  | <b>100%</b> |
| Non-Financial Corporates             | –                | –          | –         | 15%        | 23%        | <b>38%</b>  | 51%                  | 11%        | <b>62%</b> | <b>100%</b> |
| Commercial Real Estate               | –                | 5%         | 3%        | 20%        | 48%        | <b>76%</b>  | 19%                  | 5%         | <b>24%</b> | <b>100%</b> |
| <b>Total</b>                         | <b>21%</b>       | <b>12%</b> | <b>8%</b> | <b>15%</b> | <b>25%</b> | <b>81%</b>  | <b>13%</b>           | <b>6%</b>  | <b>19%</b> | <b>100%</b> |

Table 3: Fixed income portfolio by rating type

| 30 June 2016 (\$m)                   | Investment grade |              |            |              |              |              | Non-investment grade |            |              | Total        |
|--------------------------------------|------------------|--------------|------------|--------------|--------------|--------------|----------------------|------------|--------------|--------------|
|                                      | Liquids          | AAA          | AA         | A            | BBB          | Total        | BB                   | B or lower | Total        | \$m          |
| <b>Liquids</b>                       |                  |              |            |              |              |              |                      |            |              |              |
| Externally rated                     | 1,991            | -            | -          | -            | -            | <b>1,991</b> | -                    | -          | -            | <b>1,991</b> |
| Internally rated                     | -                | -            | -          | -            | -            | -            | -                    | -          | -            | -            |
| <b>Asset Backed Securities (ABS)</b> |                  |              |            |              |              |              |                      |            |              |              |
| Externally rated                     | -                | 980          | 429        | 494          | 460          | <b>2,363</b> | 184                  | 129        | <b>313</b>   | <b>2,676</b> |
| Internally rated                     | -                | 132          | 53         | 134          | 374          | <b>693</b>   | 472                  | 297        | <b>769</b>   | <b>1,462</b> |
| <b>Corporate credit</b>              |                  |              |            |              |              |              |                      |            |              |              |
| Externally rated                     | -                | 35           | 231        | 782          | 1,195        | <b>2,243</b> | 88                   | 20         | <b>108</b>   | <b>2,351</b> |
| Internally rated                     | -                | -            | -          | 22           | 232          | <b>254</b>   | 470                  | 112        | <b>582</b>   | <b>836</b>   |
| <b>Total</b>                         | <b>1,991</b>     | <b>1,147</b> | <b>713</b> | <b>1,432</b> | <b>2,261</b> | <b>7,544</b> | <b>1,214</b>         | <b>558</b> | <b>1,772</b> | <b>9,316</b> |
| Externally rated                     | 100%             | 88%          | 93%        | 89%          | 73%          | <b>87%</b>   | 22%                  | 27%        | <b>24%</b>   | <b>75%</b>   |
| Internally rated                     | -                | 12%          | 7%         | 11%          | 27%          | <b>13%</b>   | 78%                  | 73%        | <b>76%</b>   | <b>25%</b>   |

| 30 June 2016 (%)                     | Investment grade |     |     |     |     |             | Non-investment grade |            |            | Total       |
|--------------------------------------|------------------|-----|-----|-----|-----|-------------|----------------------|------------|------------|-------------|
|                                      | Liquids          | AAA | AA  | A   | BBB | Total       | BB                   | B or lower | Total      | %           |
| <b>Liquids</b>                       |                  |     |     |     |     |             |                      |            |            |             |
| Externally rated                     | 100%             | -   | -   | -   | -   | <b>100%</b> | -                    | -          | -          | <b>100%</b> |
| Internally rated                     | -                | -   | -   | -   | -   | -           | -                    | -          | -          | -           |
| <b>Asset Backed Securities (ABS)</b> |                  |     |     |     |     |             |                      |            |            |             |
| Externally rated                     | -                | 37% | 16% | 18% | 17% | <b>88%</b>  | 7%                   | 5%         | <b>12%</b> | <b>100%</b> |
| Internally rated                     | -                | 9%  | 4%  | 9%  | 25% | <b>47%</b>  | 32%                  | 21%        | <b>53%</b> | <b>100%</b> |
| <b>Corporate credit</b>              |                  |     |     |     |     |             |                      |            |            |             |
| Externally rated                     | -                | 1%  | 10% | 33% | 51% | <b>95%</b>  | 4%                   | 1%         | <b>5%</b>  | <b>100%</b> |
| Internally rated                     | -                | -   | -   | 3%  | 27% | <b>30%</b>  | 56%                  | 14%        | <b>70%</b> | <b>100%</b> |

Table 4: Fixed income portfolio by industry sector

| 30 June 2016 (\$m)            | Investment grade |              |            |              |              |              | Total        | Non-investment grade |              |              | Total |
|-------------------------------|------------------|--------------|------------|--------------|--------------|--------------|--------------|----------------------|--------------|--------------|-------|
|                               | Liquids          | AAA          | AA         | A            | BBB          | Total        |              | BB                   | B or lower   | Total        |       |
| Industrials and Consumers     | –                | 260          | 101        | 286          | 578          | <b>1,225</b> | 697          | 325                  | <b>1,022</b> | <b>2,247</b> |       |
| Residential Property          | –                | 757          | 369        | 311          | 303          | <b>1,740</b> | 85           | 167                  | <b>252</b>   | <b>1,992</b> |       |
| Banks, Financials & Insurance | 430              | 7            | 76         | 572          | 542          | <b>1,627</b> | 96           | 1                    | <b>97</b>    | <b>1,724</b> |       |
| Government                    | 1,561            | –            | –          | –            | –            | <b>1,561</b> | –            | –                    | –            | <b>1,561</b> |       |
| Commercial Property           | –                | 35           | 16         | 102          | 340          | <b>493</b>   | 253          | 44                   | <b>297</b>   | <b>790</b>   |       |
| Infrastructure & Utilities    | –                | 7            | 150        | 117          | 438          | <b>712</b>   | 54           | 21                   | <b>75</b>    | <b>787</b>   |       |
| Other                         | –                | 81           | 1          | 44           | 60           | <b>186</b>   | 29           | –                    | <b>29</b>    | <b>215</b>   |       |
| <b>Total</b>                  | <b>1,991</b>     | <b>1,147</b> | <b>713</b> | <b>1,432</b> | <b>2,261</b> | <b>7,544</b> | <b>1,214</b> | <b>558</b>           | <b>1,772</b> | <b>9,316</b> |       |

| 30 June 2016 (%)              | Investment grade |            |           |            |            |             | Total      | Non-investment grade |            |             | Total |
|-------------------------------|------------------|------------|-----------|------------|------------|-------------|------------|----------------------|------------|-------------|-------|
|                               | Liquids          | AAA        | AA        | A          | BBB        | Total       |            | BB                   | B or lower | Total       |       |
| Industrials and Consumers     | –                | 12%        | 4%        | 13%        | 26%        | <b>55%</b>  | 31%        | 14%                  | <b>45%</b> | <b>100%</b> |       |
| Residential Property          | –                | 38%        | 19%       | 16%        | 14%        | <b>87%</b>  | 4%         | 9%                   | <b>13%</b> | <b>100%</b> |       |
| Banks, Financials & Insurance | 25%              | –          | 4%        | 33%        | 32%        | <b>94%</b>  | 6%         | –                    | <b>6%</b>  | <b>100%</b> |       |
| Government                    | 100%             | –          | –         | –          | –          | <b>100%</b> | –          | –                    | –          | <b>100%</b> |       |
| Commercial Property           | –                | 4%         | 2%        | 13%        | 43%        | <b>62%</b>  | 32%        | 6%                   | <b>38%</b> | <b>100%</b> |       |
| Infrastructure & Utilities    | –                | 1%         | 19%       | 15%        | 55%        | <b>90%</b>  | 7%         | 3%                   | <b>10%</b> | <b>100%</b> |       |
| Other                         | –                | 38%        | –         | 20%        | 29%        | <b>87%</b>  | 13%        | –                    | <b>13%</b> | <b>100%</b> |       |
| <b>Total</b>                  | <b>21%</b>       | <b>12%</b> | <b>8%</b> | <b>15%</b> | <b>25%</b> | <b>81%</b>  | <b>13%</b> | <b>6%</b>            | <b>19%</b> | <b>100%</b> |       |

Table 5: Fixed income portfolio by geography and credit rating

| 30 June 2016 (\$m) | Investment grade |              |            |              |              |              | Total        | Non-investment grade |              |              | Total |
|--------------------|------------------|--------------|------------|--------------|--------------|--------------|--------------|----------------------|--------------|--------------|-------|
|                    | Liquids          | AAA          | AA         | A            | BBB          | Total        |              | BB                   | B or lower   | Total        |       |
| Australia          | 1,916            | 849          | 489        | 892          | 1,414        | <b>5,560</b> | 874          | 380                  | <b>1,254</b> | <b>6,814</b> |       |
| United States      | 18               | 106          | 30         | 234          | 444          | <b>832</b>   | 110          | 52                   | <b>162</b>   | <b>994</b>   |       |
| Rest of World      | 26               | 171          | 20         | 177          | 101          | <b>495</b>   | 76           | 56                   | <b>132</b>   | <b>627</b>   |       |
| United Kingdom     | 14               | 21           | 112        | 54           | 175          | <b>376</b>   | 43           | 20                   | <b>63</b>    | <b>439</b>   |       |
| Europe             | 15               | –            | 13         | 39           | 102          | <b>169</b>   | 71           | 7                    | <b>78</b>    | <b>247</b>   |       |
| New Zealand        | 2                | –            | 49         | 36           | 25           | <b>112</b>   | 40           | 43                   | <b>83</b>    | <b>195</b>   |       |
| <b>Total</b>       | <b>1,991</b>     | <b>1,147</b> | <b>713</b> | <b>1,432</b> | <b>2,261</b> | <b>7,544</b> | <b>1,214</b> | <b>558</b>           | <b>1,772</b> | <b>9,316</b> |       |

| 30 June 2016 (%) | Investment grade |            |           |            |            |            | Total      | Non-investment grade |            |             | Total |
|------------------|------------------|------------|-----------|------------|------------|------------|------------|----------------------|------------|-------------|-------|
|                  | Liquids          | AAA        | AA        | A          | BBB        | Total      |            | BB                   | B or lower | Total       |       |
| Australia        | 28%              | 12%        | 7%        | 13%        | 22%        | <b>82%</b> | 13%        | 5%                   | <b>18%</b> | <b>100%</b> |       |
| United States    | 2%               | 11%        | 3%        | 24%        | 44%        | <b>84%</b> | 11%        | 5%                   | <b>16%</b> | <b>100%</b> |       |
| Rest of World    | 4%               | 27%        | 3%        | 28%        | 17%        | <b>79%</b> | 12%        | 9%                   | <b>21%</b> | <b>100%</b> |       |
| United Kingdom   | 3%               | 5%         | 26%       | 12%        | 40%        | <b>86%</b> | 10%        | 4%                   | <b>14%</b> | <b>100%</b> |       |
| Europe           | 6%               | –          | 5%        | 16%        | 41%        | <b>68%</b> | 29%        | 3%                   | <b>32%</b> | <b>100%</b> |       |
| New Zealand      | 1%               | –          | 25%       | 18%        | 13%        | <b>57%</b> | 21%        | 22%                  | <b>43%</b> | <b>100%</b> |       |
| <b>Total</b>     | <b>21%</b>       | <b>12%</b> | <b>8%</b> | <b>15%</b> | <b>25%</b> | <b>81%</b> | <b>13%</b> | <b>6%</b>            | <b>19%</b> | <b>100%</b> |       |

## Property portfolio overview

Life's property portfolio of \$3.2bn (net of debt) at 30 June 2016 represented 22% of Life's total investment assets, down from 23% at 30 June 2015.

Life's property portfolio increased by \$0.3bn (net of debt) for the year as a result of a range of acquisitions and positive property revaluations, partially offset by a range of disposals.

Life is currently undertaking a property portfolio remix to ensure the portfolio delivers the required cash flows to match Life's annuity liabilities and remains a high quality and diversified portfolio. As part of Life's property portfolio remix, a number of properties were sold during FY16. All properties were sold at or above book value, with an average 12% premium to book value.

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. Excluding the properties acquired in FY16, independent valuations were undertaken for all of Life's properties during FY16.

On average the property revaluations increased by 4% in FY16 (excluding properties that were disposed of and property transaction costs written off during the period) compared to Life's normalised growth assumption of 2% per annum.

Property acquisitions incur stamp duty and acquisition costs. Under Australian accounting standards, property acquisition and transaction costs are required to initially 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 valuation and corresponding negative investment experience. During FY16, all properties acquired in either 2H15 or 1H16 were subject to either an independent valuation or directors' valuation, with \$47m of transaction costs (including stamp duty) offset against other property valuation gains.

For properties acquired in 2H16, property acquisition costs, including stamp duty of \$4m will be offset against property revaluations in 1H17.

Life's property portfolio principally comprises directly held properties and is diversified across office (48%) and retail properties (30%) with a small (6%) exposure to industrial properties.

Property includes a net \$242m exposure to Japanese property (8% of the property portfolio), consisting of suburban shopping centres that are focused on non-discretionary retailing.

Rental income is diversified across sectors and tenants, with 51% (by FY16 gross rental income) of tenants classified as investment grade (i.e. rated BBB or higher).

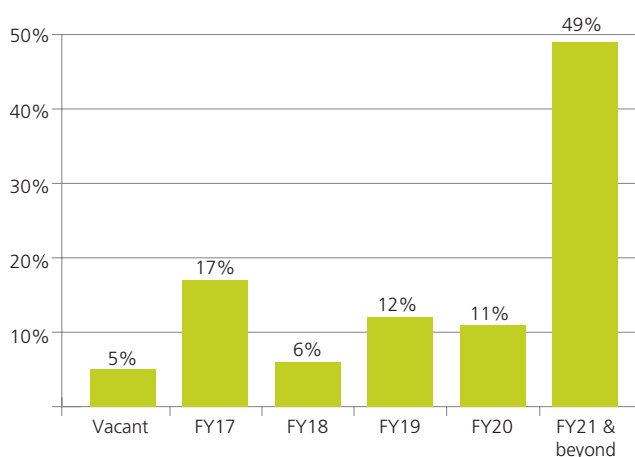
The Australian Government is a major tenant, leasing a range of commercial office buildings and accounted for approximately 32% of FY16 gross rental income.

Full details of Life's property portfolio are listed on pages 26 and 27.

## Property portfolio summary

| % of total portfolio       | FY16        | FY15        |
|----------------------------|-------------|-------------|
| Australian office          | 48%         | 47%         |
| Australian retail          | 30%         | 28%         |
| Australian industrial      | 6%          | 3%          |
| Australian listed REITs    | –           | 6%          |
| Australian unlisted REITs  | 4%          | 3%          |
| <b>Australian total</b>    | <b>88%</b>  | <b>87%</b>  |
| Japanese retail            | 8%          | 8%          |
| Other (including offshore) | 4%          | 5%          |
| <b>Total</b>               | <b>100%</b> | <b>100%</b> |

## Portfolio lease expiry overview



The property portfolio generates long term cash flows in order to match long term liabilities. Approximately 49% of contracted leases expire in FY21 and beyond demonstrating the long term nature of property cash flows.

## Direct property portfolio overview<sup>1</sup>

| <b>30 June 2016</b>         |                      | <b>Office</b> | <b>Retail</b> | <b>Industrial</b> | <b>Total</b> |
|-----------------------------|----------------------|---------------|---------------|-------------------|--------------|
| Total rent (%) <sup>2</sup> |                      | 51%           | 41%           | 8%                | 100%         |
| WALE                        |                      | 3.7           | 5.6           | 4.5               | 4.6          |
| Tenant credit ratings       |                      |               |               |                   |              |
|                             | AAA                  | 23%           | –             | –                 | 23%          |
|                             | AA                   | 8%            | –             | –                 | 8%           |
|                             | A                    | –             | 3%            | 1%                | 4%           |
|                             | BBB                  | 2%            | 10%           | 4%                | 16%          |
|                             | BB                   | 11%           | 20%           | 1%                | 32%          |
|                             | B or below           | 1%            | 1%            | 1%                | 3%           |
|                             | Not rated            | 2%            | 5%            | 2%                | 9%           |
|                             | Vacant               | 3%            | 2%            | –                 | 5%           |
|                             | <b>Total</b>         | <b>50%</b>    | <b>41%</b>    | <b>9%</b>         | <b>100%</b>  |
| % of total gross rent       |                      |               |               |                   |              |
|                             | Investment grade     | 33%           | 13%           | 5%                | 51%          |
|                             | Non-investment grade | 14%           | 26%           | 4%                | 44%          |
|                             | Vacant               | 3%            | 2%            | –                 | 5%           |

1. Direct property portfolio and jointly held assets only and excludes Australian REITS and development assets.

2. Includes vacant floors/suites available for lease.

## Direct property investments

| 30 June 2016                           | Acquisition date <sup>1</sup> | Total cost \$m <sup>2</sup> | Carrying value \$m | Cap rate FY16 % <sup>3</sup> | Last external valuation date |
|----------------------------------------|-------------------------------|-----------------------------|--------------------|------------------------------|------------------------------|
| <b>Australia</b>                       |                               |                             |                    |                              |                              |
| Office                                 |                               |                             |                    |                              |                              |
| 31 Queen Street, VIC                   | 31-Mar-11                     | 96.2                        | 118.4              | 6.50                         | 31-Dec-15                    |
| 35 Clarence Street, NSW                | 15-Jan-15                     | 145.0                       | 149.0              | 6.50                         | 31-Dec-15                    |
| 53 Albert Street, QLD                  | 12-Dec-14                     | 222.5                       | 217.5              | 6.63                         | 30-Jun-16                    |
| 215 Adelaide Street, QLD               | 31-Jul-15                     | 238.3                       | 230.0              | 6.75                         | 30-Jun-16                    |
| 565 Bourke Street, VIC                 | 28-Jan-15                     | 86.4                        | 88.6               | 6.50                         | 31-Dec-15                    |
| ABS Building, ACT                      | 01-Jan-00                     | 120.3                       | 126.5              | 7.50                         | 30-Jun-16                    |
| County Court, VIC                      | 30-Jun-00                     | 212.0                       | 290.6              | 6.50                         | 31-Dec-15                    |
| DIBP (formerly DIAC) Building, ACT     | 01-Dec-01                     | 103.3                       | 121.0              | 7.50                         | 30-Jun-16                    |
| Discovery House, ACT                   | 28-Apr-98                     | 87.4                        | 104.2              | 7.75                         | 31-Dec-15                    |
| Elder House, SA                        | 21-Jun-02                     | 48.2                        | 25.8               | 8.75                         | 30-Jun-16                    |
| Executive Building, TAS                | 30-Mar-01                     | 30.4                        | 38.2               | 7.75                         | 31-Dec-15                    |
| Makerston House, QLD                   | 14-Dec-00                     | 66.9                        | 65.4               | 8.50                         | 31-Dec-15                    |
| Retail                                 |                               |                             |                    |                              |                              |
| Bunbury Forum, WA                      | 03-Oct-13                     | 152.1                       | 151.0              | 6.50                         | 30-Jun-16                    |
| Century City Walk, VIC                 | 16-Oct-06                     | 30.1                        | 41.2               | 7.25                         | 30-Jun-16                    |
| Channel Court, TAS                     | 21-Aug-15                     | 80.1                        | 80.0               | 7.50                         | 30-Jun-16                    |
| Golden Grove, SA                       | 31-Jul-14                     | 139.1                       | 142.3              | 6.50                         | 30-Jun-16                    |
| Innaloo Cinema, WA                     | 17-Dec-01                     | 32.0                        | 44.8               | 7.25                         | 30-Jun-16                    |
| Karratha, WA                           | 28-Jun-13                     | 53.4                        | 62.3               | 7.00                         | 30-Jun-16                    |
| Kings Langley, NSW                     | 29-Jul-01                     | 15.9                        | 21.0               | 6.50                         | 30-Jun-16                    |
| Lennox, NSW                            | 27-Jul-13                     | 27.5                        | 33.5               | 6.50                         | 30-Jun-16                    |
| Next Hotel, QLD                        | 25-Mar-15                     | 142.0                       | 136.5              | 6.85                         | 31-Dec-15                    |
| North Rocks, NSW                       | 18-Sep-15                     | 135.4                       | 127.7              | 6.75                         | 30-Jun-16                    |
| Industrial                             |                               |                             |                    |                              |                              |
| 21 O'Sullivan Circuit, NT              | 27-Jan-16                     | 47.6                        | 47.6               | 7.75                         | –                            |
| 31 O'Sullivan Circuit, NT              | 27-Jan-16                     | 28.6                        | 28.6               | 8.25                         | –                            |
| 12-30 Toll Drive, Altona North, VIC    | 31-Dec-08                     | 13.9                        | 13.3               | 7.50                         | 30-Jun-16                    |
| 1-9 Toll Drive, Altona North, VIC      | 31-Dec-08                     | 3.3                         | 4.0                | 7.50                         | 30-Jun-16                    |
| 2-10 Toll Drive, Altona North, VIC     | 31-Dec-08                     | 6.3                         | 7.1                | 7.00                         | 31-Dec-15                    |
| Cosgrave Industrial Park, Enfield, NSW | 31-Dec-08                     | 56.9                        | 69.5               | 6.84                         | 30-Jun-16                    |
| Spotlight, Laverton North, VIC         | 31-Dec-08                     | 16.3                        | 20.6               | 7.00                         | 31-Dec-15                    |
| Mixed use                              |                               |                             |                    |                              |                              |
| The Barracks, QLD                      | 31-Oct-14                     | 153.2                       | 149.5              | 7.50                         | 30-Jun-16                    |
| <b>Total Australia</b>                 |                               | <b>2,590.6</b>              | <b>2,755.7</b>     |                              |                              |

<sup>1</sup> Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.

<sup>2</sup> Total cost represents the original acquisition cost plus capex.

<sup>3</sup> The capitalisation rate is derived by dividing property income over carrying value of an investment property.

## Direct property investments

| 30 June 2016                              |                                             | Acquisition date <sup>1</sup> | Total cost \$m <sup>2</sup> | Carrying value \$m | Cap rate FY16 % <sup>3</sup> | Last external valuation date |
|-------------------------------------------|---------------------------------------------|-------------------------------|-----------------------------|--------------------|------------------------------|------------------------------|
| <b>Japan</b>                              |                                             |                               |                             |                    |                              |                              |
| Retail                                    |                                             |                               |                             |                    |                              |                              |
|                                           | Aeon Kushiro                                | 31-Jan-10                     | 27.8                        | 33.0               | 5.50                         | 30-Jun-16                    |
|                                           | Carino Chitosedai                           | 31-Jan-10                     | 118.3                       | 131.2              | 4.80                         | 31-Dec-15                    |
|                                           | Carino Tokiwadai                            | 31-Jan-10                     | 77.0                        | 84.3               | 4.80                         | 30-Jun-16                    |
|                                           | DeoDeo Kure                                 | 31-Jan-10                     | 31.4                        | 31.8               | 5.80                         | 30-Jun-16                    |
|                                           | Fitta Natalie Hatsukaichi                   | 28-Aug-15                     | 11.4                        | 14.5               | 6.00                         | 31-Dec-15                    |
|                                           | Izumiya Hakubaicho                          | 31-Jan-10                     | 68.8                        | 74.4               | 5.10                         | 31-Dec-15                    |
|                                           | Kansai Super Saigo                          | 31-Jan-10                     | 13.1                        | 14.1               | 5.50                         | 30-Jun-16                    |
|                                           | Kojima Nishiarai                            | 31-Jan-10                     | 12.2                        | 14.1               | 4.90                         | 30-Jun-16                    |
|                                           | Life Asakusa                                | 31-Jan-10                     | 27.8                        | 34.8               | 4.70                         | 30-Jun-16                    |
|                                           | Life Higashinakano                          | 31-Jan-10                     | 32.9                        | 37.3               | 4.80                         | 31-Dec-15                    |
|                                           | Life Nagata                                 | 31-Jan-10                     | 25.2                        | 28.5               | 5.00                         | 30-Jun-16                    |
|                                           | MaxValu Tarumi                              | 28-Aug-15                     | 16.9                        | 20.2               | 5.80                         | 31-Dec-15                    |
|                                           | Seiyu Miyagino                              | 31-Jan-10                     | 9.7                         | 10.9               | 5.70                         | 30-Jun-16                    |
|                                           | Valor Takinomizu                            | 31-Jan-10                     | 26.8                        | 26.3               | 6.10                         | 31-Dec-15                    |
|                                           | Valor Toda                                  | 31-Jan-10                     | 42.5                        | 45.2               | 5.70                         | 30-Jun-16                    |
|                                           | Yaoko Sakato Chiyoda                        | 31-Jan-10                     | 18.2                        | 19.0               | 5.10                         | 31-Dec-15                    |
| <b>Total Japan</b>                        |                                             |                               | <b>560.0</b>                | <b>619.6</b>       |                              |                              |
| <b>Europe</b>                             |                                             |                               |                             |                    |                              |                              |
| Industrial                                |                                             |                               |                             |                    |                              |                              |
|                                           | 105 Route d'Orleans, Sully sur Loire        | 31-Dec-08                     | 27.1                        | 10.0               | 10.00                        | 30-Jun-16                    |
|                                           | Gennevilliers, 140 Rue Marcel Paul          | 31-Dec-08                     | 14.0                        | 10.1               | 9.75                         | 30-Jun-16                    |
|                                           | Parcay-Meslay, ZAC Papillon                 | 31-Dec-08                     | 10.1                        | 7.2                | 9.25                         | 30-Jun-16                    |
|                                           | Villeneuve les Beziers, Rue Charles Nicolle | 31-Dec-08                     | 18.3                        | 12.5               | 8.75                         | 30-Jun-16                    |
|                                           | Rozalia Park                                | 12-Apr-07                     | 81.1                        | 20.4               | 9.25                         | 30-Jun-16                    |
| Retail                                    |                                             |                               |                             |                    |                              |                              |
|                                           | Aulnay sous Bois, Avenue de Savigny         | 31-Dec-08                     | 20.3                        | 14.0               | 7.00                         | 30-Jun-16                    |
| <b>Total Europe</b>                       |                                             |                               | <b>170.9</b>                | <b>74.2</b>        |                              |                              |
| <b>Total Overseas</b>                     |                                             |                               | <b>730.9</b>                | <b>693.8</b>       |                              |                              |
| <b>Development</b>                        |                                             |                               |                             |                    |                              |                              |
|                                           | Enfield                                     | 31-Dec-08                     | 30.3                        | 18.7               | –                            | 30-Jun-16                    |
|                                           | Gateway                                     | 01-Jul-15                     | 51.6                        | 51.7               | –                            | –                            |
|                                           | Maitland                                    | 06-Dec-06                     | 52.1                        | 37.3               | –                            | –                            |
|                                           | TRE Data Centre                             | 14-Apr-10                     | 12.8                        | 12.8               | –                            | –                            |
| <b>Total development</b>                  |                                             |                               | <b>146.8</b>                | <b>120.5</b>       |                              |                              |
| <b>Total direct portfolio investments</b> |                                             |                               | <b>3,468.3</b>              | <b>3,570.0</b>     |                              |                              |

<sup>1</sup> Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.

<sup>2</sup> Total cost represents the original acquisition cost plus capex.

<sup>3</sup> The capitalisation rate is derived by dividing property income over carrying value of an investment property.



## Equity and other portfolio overview

Life's equity and other portfolio of \$1.1bn represented 8% of Life's total investment assets at 30 June 2016, up \$0.2bn (22%) for the year.

Listed beta equity investments (\$325m) represents investments in long only equities, including ETFs. Returns are expected to be correlated with listed equity market returns.

Unlisted beta equity investments (\$276m) represent investments managed by a range of third party investment managers. Returns are expected to be correlated to listed equity market returns.

Alternatives and other equity investments (\$478m) represents a range of investments including absolute return funds and unlisted investments. Returns are considered to generally be uncorrelated to listed equity market returns.

## Equity and other portfolio

| 30 June 2016 (\$m)     | Domestic     | Offshore     | Total          |
|------------------------|--------------|--------------|----------------|
| Listed beta            | 40.5         | 284.1        | 324.6          |
| Unlisted beta          | 67.5         | 208.6        | 276.1          |
| Alternatives and other | 151.7        | 326.6        | 478.3          |
| <b>Total</b>           | <b>259.7</b> | <b>819.3</b> | <b>1,079.0</b> |
| <b>Equity %</b>        | <b>24%</b>   | <b>76%</b>   | <b>100%</b>    |

## Infrastructure portfolio overview

Life's infrastructure portfolio of \$0.6bn (net of debt) represented 4% of Life's investment assets at 30 June 2016, and is unchanged for the year.

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 70% of the infrastructure portfolio is unlisted.

The infrastructure portfolio is diversified across a number of geographic regions and sectors. Approximately half the portfolio is invested in logistics and utility assets, predominately in Australia and the United Kingdom.

## Infrastructure portfolio by sector

| 30 June 2016        | \$m        | %           |
|---------------------|------------|-------------|
| Logistics           | 101        | 18%         |
| Utilities           | 47         | 8%          |
| Patronage           | 86         | 15%         |
| Airport             | 18         | 3%          |
| Power Generation    | 29         | 5%          |
| Renewable           | 128        | 23%         |
| Core infrastructure | 158        | 28%         |
| <b>Total</b>        | <b>567</b> | <b>100%</b> |

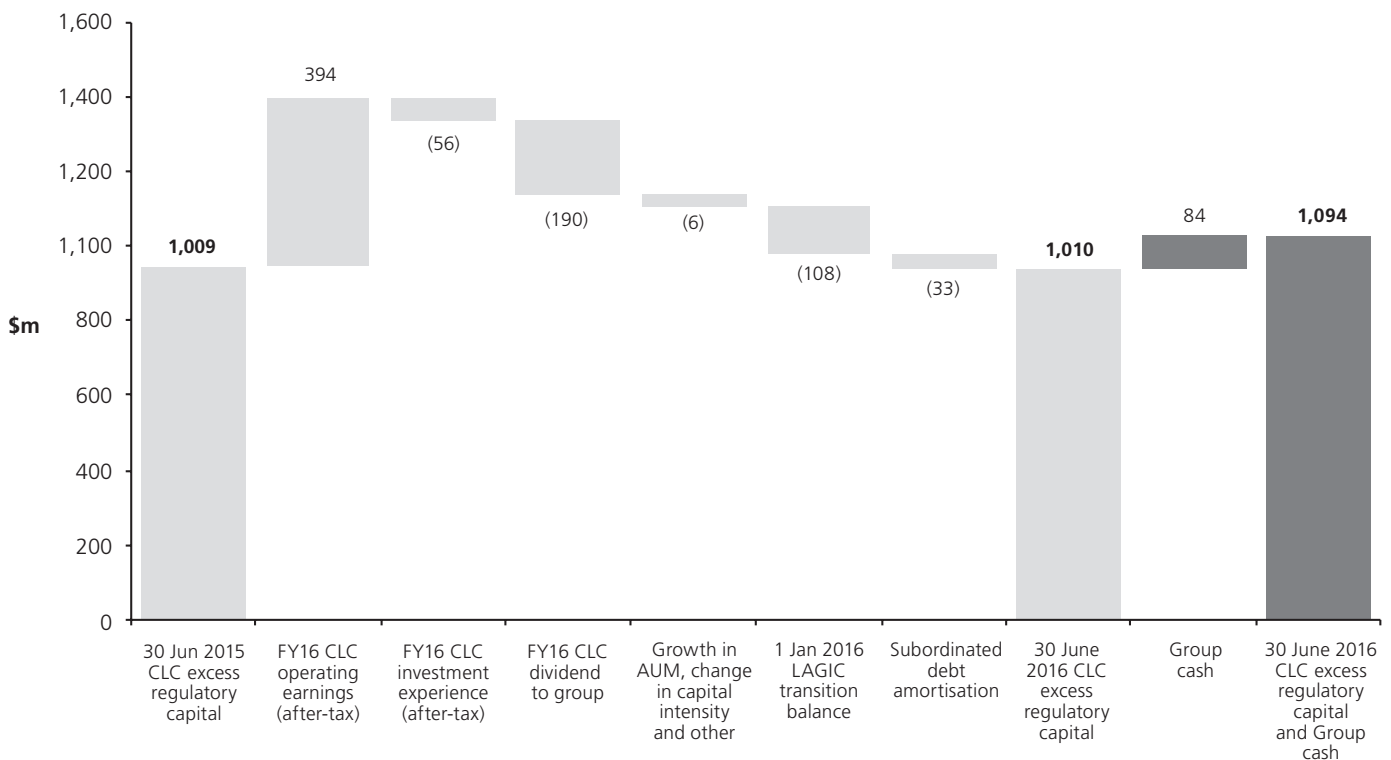
## Infrastructure portfolio by geography

| 30 June 2016   | \$m        | %           |
|----------------|------------|-------------|
| United Kingdom | 186        | 33%         |
| Europe         | 20         | 3%          |
| North America  | 39         | 7%          |
| South America  | 30         | 6%          |
| Asia           | 6          | 1%          |
| Australia      | 286        | 50%         |
| <b>Total</b>   | <b>567</b> | <b>100%</b> |

## Challenger Life Company (CLC) regulatory capital

| \$m                                                                | FY16                 | 1H16           | FY15           | 1H15           | FY14           | 1H14           |              |
|--------------------------------------------------------------------|----------------------|----------------|----------------|----------------|----------------|----------------|--------------|
| <b>CLC's excess capital under LAGIC</b>                            |                      |                |                |                |                |                |              |
| Common Equity Tier 1 (CET1) regulatory capital                     | 2,003.6              | 1,951.8        | 1,907.6        | 1,886.7        | 1,783.1        | 1,719.0        |              |
| Additional Tier 1                                                  | 345.0                | 345.0          | 345.0          | 345.0          | –              | –              |              |
| Tier 2 regulatory capital – subordinated debt <sup>1</sup>         | 445.5                | 477.5          | 474.0          | 504.7          | 476.8          | 486.8          |              |
| <b>CLC total regulatory capital base</b>                           | <b>2,794.1</b>       | <b>2,774.3</b> | <b>2,726.6</b> | <b>2,736.4</b> | <b>2,259.9</b> | <b>2,205.8</b> |              |
| <b>CLC Prescribed Capital Amount (PCA)</b>                         |                      |                |                |                |                |                |              |
| Asset risk charge                                                  | 1,712.0              | 1,731.3        | 1,773.6        | 1,718.0        | 1,530.5        | 1,517.0        |              |
| Insurance risk charge                                              | 168.3                | 132.7          | 120.5          | 143.5          | 83.9           | 68.5           |              |
| Operational risk charge                                            | 28.7                 | 22.7           | 22.6           | 23.9           | 22.8           | 20.6           |              |
| Aggregation benefit                                                | (125.3)              | (100.4)        | (91.9)         | (108.5)        | (64.7)         | (53.2)         |              |
| <b>CLC Prescribed capital amount – excluding transition relief</b> | <b>1,783.7</b>       | <b>1,786.3</b> | <b>1,824.8</b> | <b>1,776.9</b> | <b>1,572.5</b> | <b>1,552.9</b> |              |
| Transition relief                                                  | –                    | (107.6)        | (107.6)        | (215.2)        | (215.2)        | (322.8)        |              |
| <b>CLC prescribed capital amount</b>                               | <b>1,783.7</b>       | <b>1,678.7</b> | <b>1,717.2</b> | <b>1,561.7</b> | <b>1,357.3</b> | <b>1,230.1</b> |              |
| <b>CLC excess over prescribed capital amount</b>                   | <b>1,010.4</b>       | <b>1,095.6</b> | <b>1,009.4</b> | <b>1,174.7</b> | <b>902.6</b>   | <b>975.7</b>   |              |
| PCA ratio (times)                                                  | 1.57                 | 1.65           | 1.59           | 1.75           | 1.66           | 1.79           |              |
| Tier 1 ratio (times)                                               | 1.32                 | 1.37           | 1.31           | 1.43           | 1.31           | 1.40           |              |
| CET1 ratio (times)                                                 | 1.12                 | 1.16           | 1.11           | 1.21           | 1.31           | 1.40           |              |
| <b>Tier 2 regulatory capital – subordinated debt<sup>1</sup></b>   |                      |                |                |                |                |                |              |
| <b>First call date after 1 Jan 2013</b>                            | <b>Maturity date</b> | <b>FY16</b>    | <b>1H16</b>    | <b>FY15</b>    | <b>1H15</b>    | <b>FY14</b>    | <b>1H14</b>  |
| 7 Jun 2013                                                         | 7 Dec 2016           | 33.4           | 67.6           | 63.5           | 88.3           | 77.6           | 107.2        |
| 7 Dec 2016                                                         | 7 Dec 2026           | 34.1           | 35.2           | 33.9           | 31.0           | 27.5           | 28.3         |
| 7 Nov 2017                                                         | 7 Nov 2037           | 378.0          | 374.7          | 376.6          | 385.4          | 371.7          | 351.3        |
|                                                                    |                      | <b>445.5</b>   | <b>477.5</b>   | <b>474.0</b>   | <b>504.7</b>   | <b>476.8</b>   | <b>486.8</b> |

## Change in CLC excess regulatory capital and Group cash graph



1. FY16 Tier 2 regulatory capital – subordinated debt (\$446m) differs to the management balance sheet (\$577m) due to inadmissible sub-debt (\$134m) less accrued interest and amortised costs (\$3m).

# Challenger Life Company Limited (CLC) regulatory capital

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 APRA prudential capital standards. APRA issued new capital standards in October 2012 which became effective from 1 January 2013 (the Life and General Insurance Capital Standards or LAGIC).

Following the introduction of LAGIC standards, CLC's regulatory capital requirements increased by \$323m, however, APRA provided CLC a three-year transitional period which concluded on 1 January 2016.

## CLC excess regulatory capital

CLC's excess capital above APRA's prescribed capital amount at 30 June 2016 (FY16) was \$1.0bn, and was unchanged for the year. Regulatory capital increased by \$0.1bn as a result of higher retained earnings, and was offset by a \$0.1bn increase in the Prescribed Capital Amount following amortisation of the final LAGIC transition balance.

CLC's capital ratios at 30 June 2016 were as follows:

- PCA ratio of 1.57 times;
- Total Tier 1 ratio of 1.32 times; and
- Common Equity Tier 1 (CET1) ratio of 1.12 times.

APRA requires Total Tier 1 capital to be at least 80% of the PCA and CET1 capital to be at least 60% of the PCA. Both Challenger's Total Tier 1 capital ratio (1.32 times) and CET1 capital ratio (1.12 times) are well in excess of APRA's minimum requirements.

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 it provides a buffer so that CLC can continue to meet APRA's minimum requirements following adverse market or insurance risk experience. CLC uses internal capital models to determine its target surplus, which are risk-based and 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, business mix and economic circumstances. Following the completion of LAGIC transition, which completed on 1 January 2016, CLC has expanded its target PCA range to 1.3 times to 1.6 times (previously 1.4 times to 1.6 times). The increase in the target range reflects the larger and more diversified Life investment portfolio and the change in PCA mix, including a growing insurance risk charge.

## Subordinated debt

CLC's total regulatory capital base includes \$446m 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 after 1 January 2013, and will then amortise over four years.

CLC's subordinated debt includes \$167m which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only \$33m (i.e. 20% of the total amount) is included as Tier 2 regulatory capital on 30 June 2016.

The largest tranche of CLC's existing subordinated debt is a \$378m 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.

## 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. Group cash at 30 June 2016 was \$84m, down \$15m from 30 June 2015.

Challenger also maintains an undrawn Group banking facility of \$350m, which is maintained to provide additional financial flexibility. The banking facility was undrawn throughout FY16.

## APRA's Level 3 (conglomerate) capital proposals

APRA has developed 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.

In March 2016, APRA announced it would defer the Level 3 capital framework until finalisation of other domestic and international capital policy initiatives.

Based on draft Level 3 capital standards, Challenger does not expect a material impact on its regulatory capital base should these capital standards be implemented.

## Risk Management Framework

Challenger is exposed to a variety of financial risks, including market risk (currency risk, interest rate risk, equity risk), credit default risk and liquidity risk.

The management of these risks is fundamental to Challenger's business and building long term shareholder value.

The Challenger Limited Board is responsible, in conjunction with senior management, for understanding the risks associated with the business and implementing structures and policies to adequately monitor and manage these risks.

The Board has established the Group Risk Committee (GRC) and Group Audit Committee (GAC) to assist in discharging certain responsibilities. In particular, these committees assist the Board in setting the risk appetite and ensuring Challenger has an effective Risk Management Framework, incorporating management, operational and financial controls.

The Executive Risk Management Committee (ERMC) is an executive committee, chaired by the Chief Risk Officer (CRO), which assists the GRC, GAC and Board in the discharge of their risk management obligations by implementing the Board approved Risk Management Framework.

The Group's Risk Management division has day-to-day responsibility for monitoring the implementation of the framework with oversight, analysis, monitoring and reporting of risks. The CRO provides regular reporting to the GRC and the Board.

### Risk appetite

Challenger's risk appetite requires a range of financial risks, including foreign exchange, interest rate, and inflation risk to be minimised. As a result Challenger takes an active approach to hedging and limiting these financial risks.

Challenger's risk appetite statement provides that, subject to acceptable returns, Challenger can retain exposure to credit risk, property risk, equity and infrastructure risk and Life insurance risk.

| Accept exposure<br>(subject to appropriate returns) | Minimise exposure       |
|-----------------------------------------------------|-------------------------|
| ✓ Credit risk                                       | ✗ Foreign exchange risk |
| ✓ Property risk                                     | ✗ Interest rate risk    |
| ✓ Equity & infrastructure risk                      | ✗ Inflation risk        |
| ✓ Life insurance risk                               | ✗ Liquidity risk        |
|                                                     | ✗ Licence risk          |
|                                                     | ✗ Operational risk      |

### Credit default risk

Credit default risk is the risk of loss in value of an asset due to a counterparty failing to discharge an obligation.

Challenger's approach to credit management utilises a credit risk framework to ensure that the following principles are adhered to:

- credit risk management teams separation from risk originators;
- recognition of the different risks in the various businesses;
- credit exposures being systematically controlled and monitored;
- credit exposures being regularly reviewed in accordance with existing credit procedures; and
- ensuring that credit exposures include exposures arising from derivative transactions.

Challenger makes use of external ratings agencies (Standard & Poor's, Fitch, Moody's) to determine credit ratings.

Where a counterparty or debt obligation is rated by multiple external rating agencies, Challenger will use Standard & Poor's ratings where available.

All credit exposures with an external rating are also reviewed internally and cross-referenced to the external rating, if applicable. Where external credit ratings are not available, internal credit ratings are assigned by appropriately qualified and experienced credit personnel who operate separately from the risk originators.

### Credit spread risk sensitivity

Challenger is exposed to price movements resulting from credit spread fluctuations through its fixed income securities net of subordinated debt. As at 30 June 2016, a 50 basis point increase/decrease in credit spreads results in an unrealised loss/gain of \$71m (after-tax).

### Property risk

Property risk is the potential impact of movements in the market value of property investments on Challenger's profit and includes leasing risk which may impact the potential cash flow from these investments.

### Property risk sensitivity

Challenger is exposed to movements in the market value of property investments, both directly held investment properties and property securities.

The direct property sensitivities included on page 34 show the impact of a change in property valuations on balance date and are based on Life's gross direct property investments of \$3.8bn (net investments of \$3.2bn plus debt of \$0.6bn).

## Equity risk

Equity risk is the potential impact of movements in the market value of listed and unlisted equities on Challenger's profit.

Challenger holds equities as part of its investment portfolio in order to provide diversification across the investment portfolio.

### Equity risk sensitivity

Challenger is exposed to movements in the market value of listed and unlisted equity investments with a 10% move in equity markets at 30 June 2016 resulting in a \$76m (after-tax) movement in the valuation of equity investments.

## Liquidity risk

Liquidity risk is the risk that Challenger will encounter difficulty in raising funds to meet cash commitments associated with financial instruments and contracted payment obligations to annuitants. This may result from either the inability to sell financial assets at face value, a counterparty failing on repayment of a contractual obligation, or the inability to generate cash inflows as anticipated.

Challenger's liquidity policy aims to ensure that it has sufficient liquidity to meet its obligations on a short, medium and long term basis. In setting the level of sufficient liquidity, Challenger considers new business activities in addition to current contracted obligations. In determining the required levels of liquidity, Challenger considers:

- minimum cash requirements;
- collateral and margin call buffers;
- Australian Financial Services License requirements;
- cash flow forecasts;
- associated reporting requirements;
- other liquidity risks; and
- contingency plans.

Required annuity cash outflows are met from contracted investment cash flows together with assets in Challenger's liquidity pool. As a result, cash flows are well-matched and continue to be rebalanced through time.

## Life insurance risk

Lifetime annuities provide guaranteed payments to customers for life. Through selling lifetime annuities and assuming wholesale reinsurance agreements, CLC is assuming longevity risk, which is the risk annuitant customers live longer, in aggregate, than expected. This is in contrast to mortality risk, which is the risk that people die earlier than expected. CLC is exposed to mortality risk on the wholesale mortality reinsurance business.

CLC is required under APRA Prudential Standards to maintain regulatory capital in relation to the longevity, mortality and morbidity risks it carries.

CLC manages some of its longevity risk exposure by using reinsurance for closed lifetime annuity portfolios as well as regularly reviewing the portfolio for longevity experience to ensure longevity assumptions remain appropriate.

Mortality and morbidity rates are based on industry standards which are adjusted for CLC's own recent experience, and include an allowance for future rates of mortality improvement.

CLC assumes that future mortality rates for individual lifetime annuities will improve by between 0% and 2.8% per annum (FY15 1.0% and 4.0% per annum) (depending on different age cohorts). This has the impact of increasing the life expectancy of a male aged 65 from 22 years (per the base mortality rates) to 24 years.

### Mortality, morbidity and longevity sensitivities

The mortality sensitivities on page 34 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 24 years to 26 years.

## Foreign exchange risk

It is Challenger'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 Life's investments in Europe (including the United Kingdom), Japan and the United States. As a result, currency risk arises from fluctuations in the value of the Euro, British Pound, Japanese Yen and US Dollar against the Australian Dollar.

In order to protect against foreign currency exchange rate movements, Challenger enters into foreign currency derivatives which limit Challenger's exposure to currency movements.

### Foreign exchange sensitivity

The impact of movements in foreign currencies on Challenger's profit and loss and balance sheet are set out on page 34. As a result of foreign currency derivatives in place, Challenger's profit and loss is not materially sensitive to movements in foreign currency rates.

## Interest rate risk

Interest rate risk is the risk of fluctuations in Challenger's earnings arising from movements in market interest rates, including changes in the absolute level of interest rates, the shape of the yield curve, the margin between the different yield curves and the volatility of interest rates.

CLC's market risk policy sets out the relevant risk limits for interest rate exposure. It is CLC's policy to minimise the impact of interest rate movements on its projected future cash flows.

### Interest rate sensitivity

The impact of movements in interest rates on Challenger's profit and loss and balance sheet are set out on page 34.

The sensitivities assume the change in variable occurs on 30 June 2016, and are based on assets and liabilities held at that date. It is Challenger's policy to minimise the impact of movements in interest rates via the use of interest rate swaps, Australian Commonwealth Government bonds and bond futures. As a result the interest rate sensitivities on page 34 show Challenger's profit is not materially sensitive to changes in base interest rates.

## 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 and balance sheet. 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 30 June 2016.

If using these sensitivities as forward looking, an allowance for changes post 30 June 2016, 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 42 for normalised growth assumptions.

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

Refer to the Risk Management Framework (pages 31 to 33) for additional detail on how to apply the profit and equity sensitivities.

## Profit and equity sensitivities

| \$m                                                   | Change in variable | Profit/(loss) after-tax FY16 | Change in equity FY16 | Profit/(loss) after-tax FY15 | Change in equity FY15 |
|-------------------------------------------------------|--------------------|------------------------------|-----------------------|------------------------------|-----------------------|
| <b>Credit risk</b>                                    |                    |                              |                       |                              |                       |
| Fixed Income assets (change in credit spreads)        | +50 bps            | (71.3)                       | (71.3)                | (80.5)                       | (80.5)                |
|                                                       | -50 bps            | 71.3                         | 71.3                  | 80.5                         | 80.5                  |
| <b>Property risk</b>                                  |                    |                              |                       |                              |                       |
| Direct Property                                       | +1%                | 24.1                         | 24.1                  | 21.2                         | 21.2                  |
|                                                       | -1%                | (24.1)                       | (24.1)                | (21.2)                       | (21.2)                |
| Australian listed property securities                 | +10%               | –                            | –                     | 12.4                         | 12.4                  |
|                                                       | -10%               | –                            | –                     | (12.4)                       | (12.4)                |
| Other property securities                             | +10%               | 10.0                         | 10.0                  | 8.4                          | 8.4                   |
|                                                       | -10%               | (10.0)                       | (10.0)                | (8.4)                        | (8.4)                 |
| Total                                                 |                    | 34.1                         | 34.1                  | 42.0                         | 42.0                  |
|                                                       |                    | (34.1)                       | (34.1)                | (42.0)                       | (42.0)                |
| <b>Infrastructure and equity risk</b>                 |                    |                              |                       |                              |                       |
| Infrastructure investments                            | +10%               | 23.8                         | 23.8                  | 20.3                         | 20.3                  |
|                                                       | -10%               | (23.8)                       | (23.8)                | (20.3)                       | (20.3)                |
| Equity investments                                    | +10%               | 75.5                         | 75.5                  | 50.9                         | 50.9                  |
|                                                       | -10%               | (75.5)                       | (75.5)                | (50.9)                       | (50.9)                |
| Total                                                 |                    | 99.3                         | 99.3                  | 71.2                         | 71.2                  |
|                                                       |                    | (99.3)                       | (99.3)                | (71.2)                       | (71.2)                |
| <b>Life insurance risk</b>                            |                    |                              |                       |                              |                       |
| <b>Mortality, morbidity and longevity<sup>1</sup></b> |                    |                              |                       |                              |                       |
| Life insurance contract liabilities                   | +50%               | (15.1)                       | (15.1)                | (37.7)                       | (37.7)                |
|                                                       | -50%               | 15.1                         | 15.1                  | 37.7                         | 37.7                  |
| <b>Interest rate risk</b>                             |                    |                              |                       |                              |                       |
| Change in interest rates                              | +100 bps           | 4.1                          | 4.1                   | 5.1                          | 5.1                   |
|                                                       | -100 bps           | (4.1)                        | (4.1)                 | (5.1)                        | (5.1)                 |
| <b>Foreign exchange risk</b>                          |                    |                              |                       |                              |                       |
| British Pound                                         | +10%               | 0.7                          | 0.7                   | 0.3                          | 0.3                   |
|                                                       | -10%               | (0.7)                        | (0.7)                 | (0.3)                        | (0.3)                 |
| US Dollar                                             | +10%               | 7.0                          | 7.0                   | 1.9                          | 1.9                   |
|                                                       | -10%               | (7.0)                        | (7.0)                 | (1.9)                        | (1.9)                 |
| Euro                                                  | +10%               | (0.3)                        | (0.3)                 | (0.3)                        | (0.3)                 |
|                                                       | -10%               | 0.3                          | 0.3                   | 0.3                          | 0.3                   |
| Japanese Yen                                          | +10%               | –                            | 0.8                   | –                            | 0.3                   |
|                                                       | -10%               | –                            | (0.8)                 | –                            | (0.3)                 |
| Other                                                 | +10%               | 0.4                          | 0.4                   | (0.2)                        | (0.2)                 |
|                                                       | -10%               | (0.4)                        | (0.4)                 | 0.2                          | 0.2                   |

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



## Life 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 the next 20 years the number of Australians over 65, which is Life's target demographic, is expected to increase by 75%<sup>1</sup>.

Challenger Life is well positioned to benefit from changes in retiree risk preferences, including the focus on longevity risk by retirees and their advisers. Annuities address many of the financial concerns retirees face in retirement.

The retirement phase of superannuation is a high growth market driven by ageing demographics and rising superannuation balances from mandatory superannuation contributions. The annual flow moving from the accumulation phase to the retirement phase is forecast to increase by ~13%<sup>2</sup> compound annual growth over the next 10 years.

There is a growing recognition that retirees need to take a different approach to investing in retirement and there is a move toward income layering and objectives-based investing. As retirees transition from Government funded aged pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings to income and provide financial security. Annuities provide safe, secure and reliable retirement income.

The industry is responding to consumer demand with a range of new retirement income products, including the emergence of Comprehensive Income Products for Retirement (CIPR), as recommended by the Financial System Inquiry (FSI) and retirement income model portfolios.

The Australian Federal Government commissioned the FSI to provide a 'blueprint' for Australia's financial system over the next decade. The FSI report (released December 2014) recommended the retirement phase of superannuation would benefit greatly from pre-selected retirement products for members. These products would provide regular and stable income streams with longevity protection.

The Federal Government responded to the FSI recommendation in October 2015, and supported all major retirement income recommendations, including the implementation of CIPRs and is scheduled to consult on legislation by the end of 2016.

As part of the Federal Budget in May 2016, the Australian Government announced as part of its Retirement Income Streams Review, a new superannuation framework that will address current longevity product impediments and facilitate a wider range of retirement income products. The new retirement income product rules provide the building blocks for superannuation funds to develop CIPRs, as recommended by the FSI. The new rules remove the impediments to products which provide pooled longevity risk, including deferred lifetime annuities, and are scheduled to come into effect on 1 July 2017.

As part of the Federal Budget, the Australian Government also proposed the objective of superannuation was to provide income in retirement to substitute or supplement the age pension.

There are a range of Federal Government reforms currently underway to enhance the retirement income phase of Australia's superannuation system. The superannuation industry is responding and there is a growing acceptance that annuities are part of the optimal retirement income solution. Challenger is investing in technology to allow its annuities to be easily integrated with account-based pensions, in order to facilitate more comprehensive retirement income solutions.

During FY16, Challenger annuities were launched on the Colonial First State (CFS) platform, Australia's leading investment platform, providing access to half of Australia's financial adviser firms. This has resulted in a 100% increase in Challenger annuities sold via the CFS hub. Further growth is expected with a range of platform badges starting to offer Challenger annuities from FY17.

From July 2016, white labelled Challenger annuities are also available to financial advisers through Clearview Wealth Solutions which utilises the CFS platform.

In the industry fund segment, Challenger backed term and lifetime annuities have been integrated with VicSuper account based pensions to effectively create Australia's first CIPR. Challenger has also formed a partnership with the Link Group, which services the needs of 10 million Australian industry superannuation member accounts. A technology build with the Link Group was completed in FY16, allowing Link Group industry superannuation members to offer Challenger annuities to their members. In early FY17, three Link Group's clients (Local Government Super, legalsuper and caresuper) will commence offering Challenger annuities to their members.

In early FY17, Challenger entered into a strategic partnership with Suncorp Group, a leading provider of general insurance, banking, life insurance and wealth management in Australia and New Zealand. The strategic partnership will result in Challenger's term and lifetime annuity products being Suncorp branded and forming part of the longevity solutions provided to Suncorp clients.

These retail and industry platforms and partnerships are increasing Challenger's access to Australia's superannuation industry and broadening Challenger's distribution footprint.

As Australia's leading retirement income specialist, Challenger is uniquely positioned to benefit from growth in Australia's retirement incomes market and the move to more guaranteed retirement incomes. Challenger's growth is being amplified through market-leading distribution, product innovation and strong retirement incomes brand recognition.

1. Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015-2035.

2. Rice Warner 2014 Super Projections – forecasted growth over next 10 years based on existing regulatory environment.



## Funds Management financial results

| \$m                                                               | FY16             | FY15            | FY14            | 2H16            | 1H16             | 2H15            | 1H15            | 2H14            | 1H14            |
|-------------------------------------------------------------------|------------------|-----------------|-----------------|-----------------|------------------|-----------------|-----------------|-----------------|-----------------|
| <b>Fidante Partners</b>                                           |                  |                 |                 |                 |                  |                 |                 |                 |                 |
| Fidante Partners income <sup>1</sup>                              | 53.9             | 35.6            | 33.7            | 23.2            | 30.7             | 16.9            | 18.7            | 18.7            | 15.0            |
| Equity accounted profits <sup>2</sup>                             | 24.3             | 26.7            | 31.2            | 13.7            | 10.6             | 13.3            | 13.4            | 15.1            | 16.1            |
| <b>Net income</b>                                                 | <b>78.2</b>      | <b>62.3</b>     | <b>64.9</b>     | <b>36.9</b>     | <b>41.3</b>      | <b>30.2</b>     | <b>32.1</b>     | <b>33.8</b>     | <b>31.1</b>     |
| <b>Challenger Investment Partners</b>                             |                  |                 |                 |                 |                  |                 |                 |                 |                 |
| Net management fees                                               | 39.8             | 33.2            | 39.5            | 20.0            | 19.8             | 16.0            | 17.2            | 20.4            | 19.1            |
| Performance and transaction fees                                  | 9.7              | 22.0            | 5.8             | 3.7             | 6.0              | 15.2            | 6.8             | 2.2             | 3.6             |
| <b>Net income</b>                                                 | <b>49.5</b>      | <b>55.2</b>     | <b>45.3</b>     | <b>23.7</b>     | <b>25.8</b>      | <b>31.2</b>     | <b>24.0</b>     | <b>22.6</b>     | <b>22.7</b>     |
| <b>Total net fee income</b>                                       | <b>127.7</b>     | <b>117.5</b>    | <b>110.2</b>    | <b>60.6</b>     | <b>67.1</b>      | <b>61.4</b>     | <b>56.1</b>     | <b>56.4</b>     | <b>53.8</b>     |
| Personnel expenses                                                | (62.4)           | (50.2)          | (47.8)          | (31.5)          | (30.9)           | (25.4)          | (24.8)          | (24.4)          | (23.4)          |
| Other expenses                                                    | (27.9)           | (23.2)          | (19.1)          | (13.3)          | (14.6)           | (12.7)          | (10.5)          | (9.4)           | (9.7)           |
| <b>Total expenses</b>                                             | <b>(90.3)</b>    | <b>(73.4)</b>   | <b>(66.9)</b>   | <b>(44.8)</b>   | <b>(45.5)</b>    | <b>(38.1)</b>   | <b>(35.3)</b>   | <b>(33.8)</b>   | <b>(33.1)</b>   |
| <b>EBIT</b>                                                       | <b>37.4</b>      | <b>44.1</b>     | <b>43.3</b>     | <b>15.8</b>     | <b>21.6</b>      | <b>23.3</b>     | <b>20.8</b>     | <b>22.6</b>     | <b>20.7</b>     |
| <b>Performance analysis</b>                                       |                  |                 |                 |                 |                  |                 |                 |                 |                 |
| Fidante Partners – income margin (bps) <sup>3</sup>               | 19               | 15              | 20              | 18              | 20               | 14              | 16              | 20              | 20              |
| Challenger Investment Partners – income margin (bps) <sup>3</sup> | 37               | 43              | 40              | 36              | 39               | 47              | 39              | 41              | 40              |
| Cost to income ratio                                              | 70.7%            | 62.5%           | 60.7%           | 73.9%           | 67.8%            | 62.1%           | 62.9%           | 59.9%           | 61.5%           |
| Net assets – average <sup>4</sup>                                 | 159.2            | 124.3           | 132.2           | 165.9           | 151.3            | 121.7           | 127.1           | 134.3           | 131.0           |
| ROE (pre-tax)                                                     | 23.5%            | 35.5%           | 32.8%           | 19.2%           | 28.4%            | 38.6%           | 32.5%           | 33.9%           | 31.3%           |
| Fidante Partners                                                  | 43,011.5         | 44,667.0        | 35,879.4        | 43,011.5        | 41,605.1         | 44,667.0        | 42,502.5        | 35,879.4        | 33,670.8        |
| Challenger Investment Partners                                    | 13,650.2         | 13,235.4        | 11,247.1        | 13,650.2        | 13,092.9         | 13,235.4        | 12,709.4        | 11,247.1        | 11,315.0        |
| <b>Closing FUM – total</b>                                        | <b>56,661.7</b>  | <b>57,902.4</b> | <b>47,126.5</b> | <b>56,661.7</b> | <b>54,698.0</b>  | <b>57,902.4</b> | <b>55,211.9</b> | <b>47,126.5</b> | <b>44,985.8</b> |
| Fidante Partners                                                  | 41,859.6         | 42,432.9        | 33,164.3        | 41,972.9        | 41,710.0         | 44,381.9        | 40,493.9        | 34,850.7        | 31,550.2        |
| Challenger Investment Partners                                    | 13,248.0         | 12,712.8        | 11,273.8        | 13,346.3        | 13,127.5         | 13,358.2        | 12,066.9        | 11,153.7        | 11,399.8        |
| <b>Average FUM – total<sup>5</sup></b>                            | <b>55,107.6</b>  | <b>55,145.7</b> | <b>44,438.1</b> | <b>55,319.2</b> | <b>54,837.5</b>  | <b>57,740.1</b> | <b>52,560.8</b> | <b>46,004.4</b> | <b>42,950.0</b> |
| <b>FUM and net flows analysis</b>                                 |                  |                 |                 |                 |                  |                 |                 |                 |                 |
| Fidante Partners <sup>6</sup>                                     | (2,609.7)        | 6,104.4         | 2,411.7         | 1,332.1         | (3,941.8)        | 678.3           | 5,426.1         | 1,148.1         | 1,263.6         |
| Challenger Investment Partners                                    | 92.5             | 1,634.5         | (264.3)         | 507.1           | (414.6)          | 294.4           | 1,340.1         | (114.5)         | (149.8)         |
| Net flows                                                         | (2,517.2)        | 7,738.9         | 2,147.4         | 1,839.2         | (4,356.4)        | 972.7           | 6,766.2         | 1,033.6         | 1,113.8         |
| Distributions                                                     | (541.1)          | (261.7)         | (234.9)         | (203.1)         | (338.0)          | (97.2)          | (164.5)         | (105.9)         | (129.0)         |
| Market linked movement                                            | 1,817.6          | 3,298.7         | 4,110.6         | 327.6           | 1,490.0          | 1,815.0         | 1,483.7         | 1,213.0         | 2,897.6         |
| <b>Total FUM movement</b>                                         | <b>(1,240.7)</b> | <b>10,775.9</b> | <b>6,023.1</b>  | <b>1,963.7</b>  | <b>(3,204.4)</b> | <b>2,690.5</b>  | <b>8,085.4</b>  | <b>2,140.7</b>  | <b>3,882.4</b>  |

1 Fidante Partners income includes distribution fees, administration fees and other income.

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.

6 Funds Management 1H16 net flows include \$5.4bn derecognition of Kapstream following the sale in July 2015. Fidante Partners will no longer receive distribution fees on Kapstream institutional FUM (\$5.4bn) and as a result has derecognised this FUM in 1H16. Despite the reduction in FUM, Fidante Partners earnings over the short and medium term is not expected to be negatively impacted following new distribution and administration agreements.

## Assets and Funds Under Management and net flows

| \$m                                                     | Q4 16         | Q3 16         | Q2 16         | Q1 16          | Q4 15         |
|---------------------------------------------------------|---------------|---------------|---------------|----------------|---------------|
| <b>Funds Management</b>                                 |               |               |               |                |               |
| <b>Fidante Partners</b>                                 |               |               |               |                |               |
| Equities                                                | 18,317        | 17,929        | 18,754        | 17,096         | 17,323        |
| Fixed income <sup>1</sup>                               | 18,364        | 17,707        | 17,305        | 17,273         | 23,085        |
| Alternatives <sup>1</sup>                               | 6,331         | 5,880         | 5,546         | 6,141          | 4,259         |
| <b>Total Fidante Partners</b>                           | <b>43,012</b> | <b>41,516</b> | <b>41,605</b> | <b>40,510</b>  | <b>44,667</b> |
| <b>Challenger Investment Partners</b>                   |               |               |               |                |               |
| Fixed income                                            | 9,059         | 8,425         | 8,541         | 8,532          | 9,231         |
| Property                                                | 4,591         | 4,680         | 4,552         | 4,498          | 4,004         |
| <b>Total Challenger Investment Partners</b>             | <b>13,650</b> | <b>13,105</b> | <b>13,093</b> | <b>13,030</b>  | <b>13,235</b> |
| <b>Total funds under management</b>                     | <b>56,662</b> | <b>54,621</b> | <b>54,698</b> | <b>53,540</b>  | <b>57,902</b> |
| Average Fidante Partners                                | 42,539        | 41,292        | 41,071        | 42,049         | 45,018        |
| Average Challenger Investment Partners                  | 13,506        | 13,126        | 13,029        | 13,201         | 13,585        |
| <b>Average total funds under management<sup>2</sup></b> | <b>56,045</b> | <b>54,418</b> | <b>54,100</b> | <b>55,250</b>  | <b>58,603</b> |
| <b>Analysis of flows</b>                                |               |               |               |                |               |
| <b>Funds Management net flows</b>                       |               |               |               |                |               |
| Equities                                                | (51)          | (182)         | 492           | 766            | 473           |
| Fixed Income <sup>3</sup>                               | 360           | 436           | 199           | (5,050)        | 240           |
| Alternatives <sup>4</sup>                               | 434           | 336           | (765)         | 416            | (120)         |
| <b>Total Fidante Partners</b>                           | <b>743</b>    | <b>590</b>    | <b>(74)</b>   | <b>(3,868)</b> | <b>593</b>    |
| Challenger Investment Partners                          | 338           | 169           | 131           | (545)          | (314)         |
| <b>Net flows</b>                                        | <b>1,081</b>  | <b>759</b>    | <b>57</b>     | <b>(4,413)</b> | <b>279</b>    |

## Reconciliation of Total Group Assets and Funds Under Management

| \$m                                                     | Q4 16         | Q3 16         | Q2 16         | Q1 16         | Q4 15         |
|---------------------------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Funds Management (FUM)                                  | 56,662        | 54,621        | 54,698        | 53,540        | 57,902        |
| Life investment assets                                  | 14,112        | 13,102        | 13,147        | 13,021        | 12,795        |
| Adjustments to remove double counting of cross holdings | (10,723)      | (10,289)      | (10,228)      | (10,466)      | (10,908)      |
| <b>Total Assets and Funds Under Management</b>          | <b>60,051</b> | <b>57,434</b> | <b>57,617</b> | <b>56,095</b> | <b>59,789</b> |

1. In Q1 16 WyeTree Asset Management FUM (\$0.7bn) was reclassified from fixed income to alternatives.

2. Average funds under management calculated on a monthly basis.

3. Q1 16 net flows include \$5.4bn derecognition of Kapstream following the sale in July 2015. Fidante Partners will no longer receive distribution fees on Kapstream institutional FUM (\$5.4bn) and as a result has derecognised this FUM in Q116. Despite the reduction in FUM, Fidante Partners earnings over the short and medium term is not expected to be negatively impacted following new distribution and administration agreements.

4. Q1 16 alternatives net flows includes a \$0.5bn inflow following the acquisition of Dexion Capital in July 2015.

# Funds Management financial results

Challenger's Funds Management business is Australia's seventh largest investment manager<sup>1</sup> and second largest fixed income manager by FUM.<sup>2</sup>

The Funds Management business is benefiting from a clear business strategy, which is focused on investor alignment. Over the last five years FUM has increased by \$33bn, increasing by an average of 19% per annum, which is approximately three times the compound annual growth rate across the Australian funds management market.

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

In early FY16 (July 2015) Fidante Partners expanded its presence in Europe, where it already held interests in UK-based alternative asset managers, through the acquisition of Dexion Capital, which has been rebranded Fidante Partners Europe.

Funds Management also includes Challenger Investment Partners (CIP), a fixed income and property institutional investment manager, investing on behalf of both the Challenger Life Company and third party institutional investors.

## EBIT and ROE

Funds Management EBIT was \$37m and decreased by \$7m (15%) for the year.

Total net fee income increased by \$10m (up 9%) in FY16, and includes \$12m from Fidante Partners Europe, partially offset by a \$14m reduction in performance and transaction fees.

Total expenses increased by \$17m (up 23%), with the increase fully attributed to the Fidante Partners Europe business.

Funds Management EBIT includes a \$10m loss from Fidante Partners Europe, which is due to low transaction activity which was impacted by market uncertainty in the lead up to the United Kingdom vote to leave the European Union (Brexit).

FY16 Funds Management ROE was 23.5% and decreased from 35.5% in FY15. The decrease in ROE is directly attributable to the Fidante Partners Europe EBIT loss (\$10m) and lower performance and transaction fees (down \$14m) in FY16.

## Total net fee income

FY16 total net fee income increased by \$10m (9%), with Fidante Partners net fee income increasing by \$16m (26%), which was partially offset by a \$6m (10%) reduction in Challenger Investment Partners net income.

## Fidante Partners

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 a share of performance fees earned by boutique investment managers, which is included in both Fidante Partners' net income and equity accounted profits.

Fidante Partners' total net income was \$78m in FY16, up \$16m (26%) for the year, with Fidante Partners' income increasing by \$18m and equity accounted profits decreasing by \$2m.

Fidante Partners FY16 income includes a \$12m contribution from Fidante Partners Europe benefiting from higher average FUM.

Fidante Partners' equity accounted profits decreased by \$2m in FY16 due to no equity accounted profit contribution from Kapstream following its sale in July 2015.

Fidante Partners' net income also includes a share of performance fees earned by boutique investment managers. FY16 performance fees were \$7m, down from \$9m in FY15.

Fidante Partners' FY16 income margin (net income to average FUM) was 19 bps, up 4 bps from FY15. The increase in net income margin was due to:

- a contribution from Fidante Partners Europe (+3 bps);
- increased margin from Kapstream following the derecognition of institutional FUM with no earnings impact and a change in FUM mix (+2 bps); partially offset by
- lower performance and transaction fees (-1 bps).

## Challenger Investment Partners

Challenger Investment Partners' net income decreased by \$6m (10%) in FY16, with net management fees increasing by \$6m and performance and transaction fees decreasing by \$12m.

Challenger Investment Partners' management fees increased as a result of new third party property mandates. Performance and transaction fees decreased as a result of lower fixed income transaction fees and no infrastructure fees earned in FY16.

Challenger Investment Partners' FY16 income margin (net income to average FUM) was 37 bps, down 6 bps from FY15. The decrease in income margin is due to:

- lower performance and transaction fees (-10 bps); partially offset by
- change in FUM mix (+4 bps) due to a higher proportion of property FUM.

## Expenses

FY16 total expenses were \$90m, and increased by \$17m (23%) in FY15. The increase is entirely due to Fidante Partners Europe expenses, following the Dexion Capital acquisition in July 2015.

1. Consolidated FUM for Australian fund managers – Rainmaker Roundup March 2016.

2. Australian fixed income investment managers - Rainmaker Roundup March 2016.

The FY16 cost to income ratio was 70.7%, up from 62.5% in FY15. The increase in the cost to income ratio is due to the Fidante Partners Europe operating result and lower performance and transaction fees.

## Funds Under Management (FUM)

Total FUM at 30 June 2016 was \$56.7bn, down \$1.2bn from FY15. Fidante Partners FUM decreased by \$1.7bn, including the \$5.4bn of Kapstream institutional FUM derecognised following the sale of Fidante Partners' equity interest in Kapstream to Janus Capital in July 2015. Challenger Investment Partners' FUM increased by \$0.5bn.

## Fidante Partners FUM and net flows

Fidante Partners' FUM at 30 June 2016 (FY16) was \$43.0bn, down \$1.7bn (4%) for the year. The decrease in Fidante Partners FY16 FUM was due to:

- \$5.4bn of Kapstream institutional FUM derecognised following the sale of Fidante Partners' equity interest in Kapstream to Janus Capital in July 2015; partially offset by
- \$0.5bn of FUM included following the acquisition of Fidante Partners' Europe in July 2015;
- \$2.2bn of organic net flows; and
- \$1.0bn of positive market movements net of distributions.

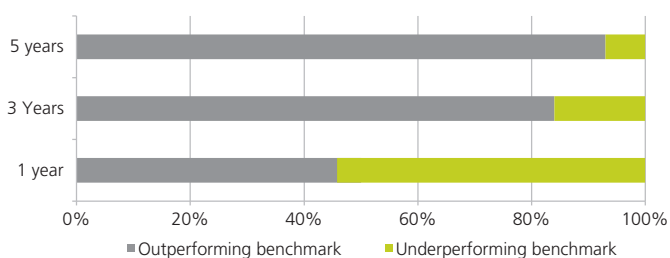
Fidante Partners' organic net flows of \$2.2bn include:

- \$1.0bn in equity products;
- \$1.3bn in fixed income products;
- \$1.0bn in alternative flows from new Fidante Partners' European boutiques; offset by
- \$1.1bn in alternative outflows from Whitehelm Capital and WyeTree Asset Management.

Approximately 43% of Fidante Partners' FY16 FUM is invested in fixed income, 42% in equity products and 15% in alternatives (e.g. infrastructure) products.

## Fidante Partners' investment performance

Fidante Partners' investment performance represents the percentage of FUM meeting or exceeding performance benchmarks. Total investment performance and is weighted by boutique FUM.



Fidante Partners' investment performance has remained strong over an extended period. Over five years, 94% of FUM has exceeded benchmark. Over one year, 45% of FUM exceeded benchmark, with no systemic issues driving the under performance. Investment performance across the larger boutique funds was strong in July 2016.

## Challenger Investment Partners' (CIP) FUM and net flows

Challenger Investment Partners' FUM at 30 June 2016 was \$13.7bn, which was up \$0.5bn (4%) for the year.

The increase in Challenger Investment Partners' FY16 FUM was due to:

- \$0.4bn of third party flows;
- \$0.4bn of positive market movements; partially offset by
- \$0.3bn Life mandate reduction. Life increased its property mandate by \$0.1bn and decreased its fixed income mandate by \$0.3bn.

Approximately 66% of Challenger Investment Partners' FY16 FUM is invested in fixed income and approximately 34% is invested in property.

Third party clients account for 26% of Challenger Investment Partners' FUM, up from 24% in FY15.

## Sale of Kapstream and new distribution agreements

In early FY16 (July 2015), Fidante Partners sold its 25% equity interest in global fixed income boutique investment manager Kapstream, to US-based Janus Capital Group Inc. (Janus) for \$45m. Fidante Partners also entered into new distribution and administration agreements with both Kapstream and Janus, as a result Fidante Partners' earnings over the short and medium term are not expected to be impacted.

Challenger recognised a \$40m pre-tax profit on sale of Kapstream which is disclosed as a FY16 significant item.

Kapstream FUM at 30 June 2015 was \$9.2bn and comprised retail FUM of \$3.8bn and institutional FUM of \$5.4bn. Following the sale of Kapstream, Fidante Partners continues to receive administration and distribution fees on Kapstream retail FUM (\$3.8bn), however will no longer receive distribution fees on institutional FUM (\$5.4bn). As a result, on 1 July 2015, Fidante Partners derecognised Kapstream institutional FUM of \$5.4bn.

## Boutique impairments

In FY16 the decision was made to exit both the Arete and Metisq boutique funds management businesses. This decision was made as they lacked sufficient scale, with low levels of FUM and made an immaterial contribution to Funds Management earnings. The closure of both Arete and Metisq resulted in a \$12m (after-tax) impairment cost in FY16 significant items.

## Fidante Partners Europe (Dexion Capital)

In July 2015 Fidante Partners acquired 100% of Dexion Capital Holdings Limited (rebranded to Fidante Partners Europe), a European alternative investments group comprising interests in three specialist fund managers, as well as an investment distribution business that assist closed-end alternative investment companies attract capital via IPO listings. Fidante Partners Europe employs approximately 40 staff, predominately based in London.

The strategic acquisition substantially expands Fidante Partners' presence in Europe where it already holds interests in UK-based alternative asset managers Whitehelm Capital (global infrastructure) and WyeTree Asset Management (asset-backed securities). The acquisition also provides Fidante Partners with established distribution to UK and European alternative asset focused investors.

The acquisition completed in July 2015 for an agreed fixed payment of ~\$45m. The final acquisition price is dependent on profitability over a period of up to six years, under earn-out arrangements with key executives.

Since the acquisition completed in July 2015, Fidante Partners has:

- substantially integrated the business and combined London offices;
- rebranded the business to Fidante Partners Europe, reflecting the need to unite Fidante Partners people across the business as part of one brand and culture;
- updated the European boutique sourcing strategy to ensure boutiques meet the demand from European alternatives investors;
- achieved strong boutique flows in FY16, resulting in boutique FUM doubling since acquisition to over \$1.3bn; and
- established a UCITS (Undertakings for Collective Investment in Transferable Securities) platform to provide a single European regulatory framework for investment vehicles, with four products launched and \$0.2bn raised.

Due to market uncertainty in the UK caused by Brexit, UK financial transaction activity stalled affecting the part of the business that raises capital for closed-end listed alternative asset managers. This market is expected to eventually return to more normal conditions as uncertainty subsides.

## Funds Management outlook

The Australian funds management market remains an attractive market underpinned by mandated superannuation contributions. Contributions are currently 9.5% of gross salaries and are scheduled to increase to 12% by 2025. The mandated nature of Australia's superannuation system is expected to significantly grow the size of Australia's superannuation assets from \$2 trillion to \$10 trillion over the next 20 years.<sup>1</sup>

Funds Management's superior FUM growth can be partly attributed to the strength of Challenger's retail and institutional distribution teams, with Challenger's Funds Management business winning the Professional Planner/Zenith Fund Awards 2015 'Distributor of the Year'.

Fidante Partners continues to identify new investment manager talent and is adding capacity to existing managers as well as expanding its platform in Europe. The platform is diversified across managers and across different asset classes.

Funds Management has recently implemented an Emerging Manager Program in order to source and attract new boutique investment managers.

The acquisition and integration of Fidante Partners Europe has substantially expanded Fidante Partners' successful multi-boutique model into the European market, whilst opening up global distribution opportunities for existing boutique investment managers.

Challenger Investment Partners continues to build out its client base and product offering. There are opportunities to add new mandates from domestic and international institutions, superannuation funds and sovereign wealth funds. As a result of the low (or negative) interest rate environment across the globe, there is high demand from foreign investors seeking higher absolute return Australian assets.

Challenger's Funds Management business is very well positioned to benefit from growth in Australia's superannuation system. The Funds Management platform has multiple brands and strategies with scalable platforms in both Australia and Europe.

Funds Management has approximately \$100 billion of available FUM capacity, and when coupled with Challenger's distribution capability, institutional strength administration platform and long-term boutique investment manager performance, provides a strong base to continue to grow the business.

1. Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015-2035.

## Corporate financial results

| \$m                                        | FY16          | FY15          | FY14          | 2H16          | 1H16          | 2H15          | 1H15          | 2H14          | 1H14          |
|--------------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| <b>Other income</b>                        | <b>1.0</b>    | <b>1.3</b>    | <b>1.8</b>    | <b>0.4</b>    | <b>0.6</b>    | <b>0.6</b>    | <b>0.7</b>    | <b>0.6</b>    | <b>1.2</b>    |
| Personnel expenses                         | (37.1)        | (36.8)        | (34.3)        | (19.1)        | (18.0)        | (18.5)        | (18.3)        | (17.7)        | (16.6)        |
| Other expenses                             | (13.0)        | (10.1)        | (10.4)        | (6.6)         | (6.4)         | (5.5)         | (4.6)         | (5.6)         | (4.8)         |
| <b>Total expenses (excluding LTI)</b>      | <b>(50.1)</b> | <b>(46.9)</b> | <b>(44.7)</b> | <b>(25.7)</b> | <b>(24.4)</b> | <b>(24.0)</b> | <b>(22.9)</b> | <b>(23.3)</b> | <b>(21.4)</b> |
| Long term incentives (LTI) <sup>1</sup>    | (16.6)        | (16.8)        | (16.7)        | (8.6)         | (8.0)         | (8.8)         | (8.0)         | (8.4)         | (8.3)         |
| <b>Total expenses</b>                      | <b>(66.7)</b> | <b>(63.7)</b> | <b>(61.4)</b> | <b>(34.3)</b> | <b>(32.4)</b> | <b>(32.8)</b> | <b>(30.9)</b> | <b>(31.7)</b> | <b>(29.7)</b> |
| <b>Normalised EBIT</b>                     | <b>(65.7)</b> | <b>(62.4)</b> | <b>(59.6)</b> | <b>(33.9)</b> | <b>(31.8)</b> | <b>(32.2)</b> | <b>(30.2)</b> | <b>(31.1)</b> | <b>(28.5)</b> |
| Interest and borrowing costs               | (4.1)         | (3.8)         | (4.1)         | (1.8)         | (2.3)         | (2.1)         | (1.7)         | (1.9)         | (2.2)         |
| <b>Normalised profit/(loss) before tax</b> | <b>(69.8)</b> | <b>(66.2)</b> | <b>(63.7)</b> | <b>(35.7)</b> | <b>(34.1)</b> | <b>(34.3)</b> | <b>(31.9)</b> | <b>(33.0)</b> | <b>(30.7)</b> |

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

FY16 Corporate normalised loss before tax was \$70m and increased by \$3m (5%) compared to FY15, primarily due to higher expenses (up \$3m).

### Other income

Other income includes interest received on Group cash balances and was unchanged from FY15.

### Total expenses

FY16 total expenses were \$67m, up \$3m on FY15 due to higher other expenses.

Long term incentive costs relate to the non-cash amortisation of equity grants and were largely unchanged from FY15.

### Interest and borrowing costs

FY16 interest and borrowing costs were \$4m which was largely unchanged from FY15.

The Group debt facility was undrawn during FY16, with interest and borrowing costs reflecting debt facility fees.

The Group maintains a \$350m banking facility in order to provide additional financial flexibility.

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



## Normalised profit framework

Life 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 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).

|                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|----------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Cash earnings</b>             | <p>Cash earnings represents investment yield, less interest expenses and distribution expenses.</p> <p><b>Investment yield</b><br/>Represents the investment return on assets held to match annuities and the return on shareholder investment assets.</p> <p>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.</p> <p><b>Interest expense</b><br/>Represents interest accrued at contracted rates to annuitants and Life subordinated debt holders and other debt holders.</p> <p><b>Distribution expenses</b><br/>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).</p> <p><b>Other income</b><br/>Other income includes revenue from Accurium and profits on Life Risk wholesale longevity and mortality transactions (refer to page 16).</p>                                                                                                                                                                                                                                                                                                        |
| <b>Normalised capital growth</b> | <p>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.</p> <p>Normalised capital growth can be determined by multiplying the normalised capital growth assumption (see below) by each asset class average balance for the period (net of debt).</p> <p>Normalised capital growth assumptions for FY16 are as follows:</p> <ul style="list-style-type: none"> <li>• Fixed income and cash – negative 0.35% representing an allowance for credit defaults;</li> <li>• Property – 2.00%;</li> <li>• Infrastructure – 4.00%; and</li> <li>• Equity and alternative asset classes – 4.50% (reduced from 6.00% in FY15).</li> </ul> <p>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.</p> <p>From 1 July 2015 (FY16), the assumed equities normalised growth assumption reduced from 6.0% per annum to 4.5% per annum to reflect lower expected returns. This includes both lower global economic growth expectations (i.e. lower equities risk premia) and the nature of Challenger's equities portfolios, which consists of both listed and unlisted equities.</p> |

## Normalised profit framework

### **Investment experience**

Challenger Life is required by accounting standards and prudential 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 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, losses on new business 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 but does not satisfy all the criteria to be included in common equity tier 1 regulatory capital.                      |
| Cash earnings (Life)                             | Investment yield and other income less interest and distribution expenses.                                                                                                                                                                |
| 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 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.                                                                                                                                                      |
| Distribution expenses (Life)                     | Payments made for the acquisition and management of annuities and other Life products.                                                                                                                                                    |
| Fidante Partners' income (FM)                    | Distribution and administration fees and other income from boutique investment managers.                                                                                                                                                  |
| Funds under management (FUM)                     | Total value of listed and unlisted funds/mandates managed by the Funds Management business.                                                                                                                                               |
| Group cash                                       | Cash available to Group excluding cash held by Challenger Life Company Limited.                                                                                                                                                           |
| 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 holders and other debt providers.                                                                                                                                         |
| Investment experience (Life)                     | The difference between actual investment gains/losses (both unrealised and realised) and the normalised capital growth assumption 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 annuity policy receipts                 | Life retail annuity sales less annuity capital payments.                                                                                                                                                                                  |
| Life net book growth                             | Life net annuity policy capital receipts over the period divided by the opening Life annuity book and Guaranteed Index Return liabilities.                                                                                                |
| Life total net book growth                       | Life net annuity and other policy capital receipts over the period divided by the opening Life annuity book and Guaranteed Index Return liabilities.                                                                                      |
| Net assets – average (Group)                     | Average net assets over the period (excluding non-controlling interests) 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

| <b>Terms</b>                                 | <b>Definitions</b>                                                                                                                                                                                                                                   |
|----------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 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 and 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 interest received on Group cash balances.                                                                                                                                                                                                   |
| Other income (Life)                          | Relates to Accurium revenue and Life Risk. Refer to page 16 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                                    | The ratio of the total CLC tier 1 and tier 2 regulatory capital base divided by the 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 and distribution expenses.                                                                                                                                         |
| 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 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 capital 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).                                                                                                                                                    |

