

## MARKET RELEASE

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### CHALLENGER LIMITED 1H15 RESULTS

**Total annuity sales of \$2.1 billion, with \$12.4 billion now managed by Challenger Life**

Record retail annuity sales of \$1.6 billion, up 8%, driving net book growth of 7.2% and a FY15 target range of 11%-13%

**Funds Management net flows of \$6.8 billion, with FUM up 17% to \$55.2 billion**

Organic net flows of \$2.1 billion directed primarily into fixed income funds and commercial property

**Interim dividend of 14.5 cents per share, up 16%**

Increase in franking to 70% arising from higher tax payments

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**17 February 2015, Sydney** – Challenger Limited (ASX:CGF) today announced another strong first half operating result due to its highest-ever retail annuity sales, as well as continued strong net flows into its Fidante Partners boutique funds management business.

Total assets under management across Life and Funds Management were \$57.2 billion at 31 December 2014, 17% higher than twelve months prior. Management of these assets produced normalised earnings before interest and tax (EBIT) of \$206 million, up 7%, and normalised net profit after tax (NPAT)<sup>1</sup> of \$155 million. Statutory profit was \$130 million.

Challenger's Chief Executive Officer Mr Brian Benari said: "Pre-tax earnings continue to grow at a pleasing rate despite a backdrop of market volatility and a declining risk-free rate. Fortunately, the uncertain market environment has also been a driver of strong fixed income fund flows and record retail annuity sales, with retirees valuing the attractive risk-adjusted returns of capital-backed, guaranteed annuities".

Shareholder income over the period rose substantially, with the Board declaring a 70% franked interim dividend of 14.5 cents per share, up 16% on the prior corresponding period (pcp). This dividend rise was achieved despite a temporary reduction in headline earnings per share (EPS) against the pcp arising from higher tax expense of \$15 million due to the roll-off of a TOFA<sup>2</sup> tax benefit in 2014.

"Retail annuity sales have continued to grow strongly yet we're only four years into the 20 year retirement phase of Australia's 4 million plus Baby Boomers. As the wealthiest generation in history, the Boomers have a lot to lose, so place a very high value on capital preservation, as reflected in the size of our average annuity sale, which has grown from \$80,000 to \$200,000 over the last decade.

"A trend to longer-term guaranteed 'income layering' has also become more evident among retirement-focused advisers, wealth managers, asset consultants, research houses and super funds. When you add to this the FSI's recommendation that super funds be required to pre-select certain income stream products with longevity protection, and Treasury's review of the obstacles preventing the issuance of deferred lifetime annuities, Challenger is clearly very well positioned for continued growth," said Mr Benari.

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<sup>1</sup> As required by Life insurance accounting standards, statutory NPAT includes realised and unrealised movements in the value of assets and liabilities. The Normalised profit figures are non-statutory amounts and in Challenger's view better reflect the underlying operating performance of the business. The Normalised profit figures exclude investment experience, being the difference between actual investment gains and losses (both realised and unrealised) and the normalised gains and losses (being based on Challenger's long term assumed returns). The Normalised profit framework and a reconciliation to statutory profit have been disclosed on page 7 in the Director's Report and Note 2 - segment information in the Challenger Limited 31 December 2014 financial report. The Normalised Profit is not audited but has been subject to a review performed by Ernst & Young.

<sup>2</sup> Taxation of Financial Arrangements reforms.

While investment in growth initiatives increased in the half-year to support recently announced partnerships, the company achieved a cost to income ratio of 34.4% (FY14: 34.6%), well within its targeted range of 32% to 36%.

Group statutory NPAT of \$130 million resulted from \$25 million of negative investment experience over the period, compared with \$3 million of positive investment experience in 1H14. 'Investment experience' includes unrealised gains and losses on the 'mark to market' value of Challenger Life's assets and liabilities. Even when a life company intends to retain the relevant assets and liabilities to maturity, Life insurance accounting rules require unrealised amounts to be booked through the statutory profit and loss statement. While this regulatory requirement can make life company reported statutory profit more volatile than if historic cost rules applied (as with banks), its purpose is to give annuitants a high degree of transparency and confidence that life companies can meet their promises at any time.

The company's pre-tax normalised return on equity was 17.4% as a result of the progressive deployment of new capital, and Challenger ended the period with \$1.3 billion excess regulatory capital and Group cash.

### Life (annuities)

Total annuity product sales were \$2.1 billion, up 22% on pcp, and comprising record retail sales of \$1.6 billion, up 8%, and institutional sales (reinvestments for terms up to three years) of \$549 million.

Of the \$1.6 billion in retail sales, \$1.3 billion were fixed term annuities, with lifetime annuities accounting for the balance of \$319 million, and setting a new high-water mark for first half lifetime sales (1H14: \$270 million). Lifetime annuities now comprise 23% of Challenger Life's total retail annuity book, which grew by \$561 million during the period, or 7.2%.

"It's worth noting that Challenger experienced record first-half lifetime annuity sales during a time of industry debate about the purported need for innovative new longevity products to drive uptake among Australia's retirees", said Mr Benari.

"While we support new thinking in this area, we caution that industry innovation shouldn't come at the expense of retiree safety. While other wealth managers might express frustration at the cost of servicing the capital required to back lifetime promises, we think Australian retirees value the capital strength of a prudentially regulated financial institution".

Challenger Life had \$12.4 billion under management as at 31 December 2014. Average assets under management over the period was \$11.6 billion, up 9% and against which a stable margin of 4.4% delivered Life cash operating earnings (COE) of \$258 million, an increase of 9%.

Challenger Life continued its strategic re-weighting to commercial property during the half-year with the acquisition of three office and retail buildings for a combined value of \$514 million and the exchange of contracts on another \$311 million which are due to settle in the second half.

"While our total assets make us a mid-tier property player, we have the ability to pool capital from co-investors through Challenger Investment Partners, and have the expertise to invest across the capital structure, meaning we're often able to cherry-pick debt and equity transactions in the Australian commercial, office and retail property markets", said Mr Benari.

### Funds Management – Fidante Partners and Challenger Investment Partners (CIP)

Funds Management's total net flows were \$6.8 billion, up from \$1.1 billion in the pcp, and average funds under management (FUM) rose 22% to \$52.6 billion, resulting in EBIT of \$21 million and delivering a pre-tax ROE of 32.5%, up from 31.3% a year earlier.

Within the Fidante Partners boutique funds division, FUM rose 18% with organic net flows of \$1.6 billion due to strong performances by its fixed income managers. First flows were also recorded for smart beta boutique Tempo Asset Management, established in 2014 to implement innovative active investment strategies which aim to outperform global equities indices.

As previously announced to the market, on 1 July 2014, \$3.9 billion was transferred to Fidante's FUM due to the formation of new infrastructure boutique Whitehelm Capital from the merger of Challenger's infrastructure business with that of Access Capital Advisers.

Challenger Investment Partners increased its FUM by 13% and was awarded 'Australian Credit Fund Management House of the Year' at the 2014 KangaNews awards.

### **Distribution, Product and Marketing (DPM)**

DPM is responsible for designing, marketing and selling the products and solutions offered by Challenger Life, and was very active over the period, implementing new growth initiatives and executing on its core annuity distribution activities.

In addition to the announced annuity partnerships with VicSuper and Colonial First State, DPM continued to grow the footprint of its adviser education activities, presenting the 'income-layering' approach to retirement planning to more than 1,500 advisers during professional development days and master-classes.

Challenger is committed to thought leadership in the retirement incomes arena, so became a major supporter of an Australian educational first; the creation of a new degree course in retirement planning, offered by the University of New South Wales (UNSW) as part of its Master of Financial Planning degree.

Challenger's national television advertising campaign 'Retirement on Paper', won the company's ninth and tenth brand advertising awards, and continued to drive growth in brand and product category awareness and consideration, with 72% of retirees having heard of the Challenger brand, and 40% willing to consider annuities as a retirement investment. Consumer advertising is also generating pull-through demand, with 45% of advisers experiencing a reverse customer enquiry about annuities during the period.

Challenger continues to build on its pre-eminent status as a retirement income brand among financial advisers. According to an independent brand survey conducted in late January 2015, 76% of financial advisers regard Challenger as the first or second 'top of mind' retirement brand, and 97% nominated Challenger as a leader in retirement incomes.

### **Capital**

Challenger Life has further strengthened its capital position and, as at 31 December 2014, held substantially more regulatory capital than required by APRA, being 1.8 times its Prescribed Capital Amount (PCA), above its target ratio range of 1.4 times to 1.6 times.

### **Outlook**

Challenger reaffirms Life's cash operating earnings guidance of \$535 million to \$545 million for FY15 and has set a retail annuity net book growth target of 11%-13% to account for the lead time associated with finalising the development and marketing of a new Care Annuity product.

Mr Benari said: "Our existing retail distribution strategies are expected to deliver a second-half of strong annuity sales growth, aided by the growing acceptance of outcomes-based retirement planning within the superannuation industry. With the flow of super money into the retirement phase expected to triple to \$190 billion per year over the next decade, Challenger remains extremely well-positioned in its annuities business. We're also looking forward to evaluating new opportunities for the Fidante Partners boutiques business in Australia and potentially offshore".

*ENDS*