

## MARKET RELEASE

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### CHALLENGER LIMITED FY14 RESULTS

**Total annuity sales of \$3.38 billion, with \$11.1 billion now managed by Challenger Life**

Record retail annuity sales of \$2.8 billion, up 28%. Record lifetime annuity sales of \$613 million, up 139%, and more than the entire annuity industry has sold in any year

**Funds management net flows of \$2.1 billion, with a 15% rise in FUM to \$47.1 billion**

In addition, five new boutiques and new strategies have created another \$36 billion in investment capacity

**Capital initiatives to fund growth**

Capital initiatives will assist the achievement of step-up increases in Challenger Life's FY15 retail book growth target range to 12%-14% and cash earnings guidance to \$535-\$545 million.

\$280 million is expected to be raised from an institutional share placement and Share Purchase Plan. \$250 million is expected to be raised in September by a listed convertible notes issue.

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**20 August 2014, Sydney** – Challenger Limited (ASX: CGF) today announced another year of record flows into its annuities business and another strong earnings performance from its funds management division.

Total assets under management across Life and Funds Management stood at \$50.7 billion at 30 June 2014, 13% higher than twelve months prior. Management of these assets produced normalised EBIT of \$388 million, up 6%, and normalised NPAT\* of \$329 million, an increase of 7%. Statutory profit was \$341 million. The group continues to grow quickly yet efficiently, with a cost to income ratio of 34.6%, well within its guidance range.

Chief Executive Officer Brian Benari said: "Challenger has recorded five straight years of retail annuity sales growth, and has unambiguous expansion prospects. It's time to change gears so we can capitalise on the opportunities before us.

"Lifetime annuity sales growth has been phenomenal, hitting \$613 million from only \$46 million two years ago. But the post-retirement market remains largely untapped, because this year saw more than \$66 billion a year flow from the savings phase to the pension phase of super.

"Similar growth opportunities await our boutique funds management business. We have close to \$50 billion in FUM and the same again in available capacity, with diversification by asset class and product and strong investment track records.

"Challenger is uniquely positioned to capture a healthy share of super and retirement flows over the next twenty years", said Mr Benari.

The company's normalised earnings per share (EPS) grew by 9% to 64.0 cents per share (cps) for FY14. The full year dividend was 26.0 cps following the Board's declaration of a partially franked final dividend of 13.5 cps.

"Strong cash flow and sustainable earnings growth has allowed us to increase distributions to shareholders this year. We grew total dividends by 30%, lifted the overall payout ratio from 34% to 41% and recommenced franking. We intend to build on this next year by targeting a 45%-50% payout ratio, 70% franked interim dividend and 100% franked final dividend", said Mr Benari.

The company's post-tax normalised return on equity was 16%, and it ended the financial year with \$1.044 billion of group cash and Challenger Life excess regulatory capital, including the LAGIC transition amount.

Group statutory NPAT was \$341 million with \$12 million of positive investment experience over the year, compared with \$100 million of positive investment experience in FY13. “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, strict 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.

## Life (annuities)

Total annuity product sales reached a milestone of \$3.38 billion, up 8% on last year, and comprising record retail sales of \$2.8 billion, up 28%, and institutional sales of \$582 million.

Of the \$2.8 billion in retail sales, \$2.186 billion were fixed term annuities, with lifetime annuities comprising the balance of \$613 million, up from \$257 million in FY13 (FY12: \$46 million). Notably, lifetime annuities now comprise 22% of total annuity sales, up from 12% in FY13 (FY12: 2%).

Challenger’s retail annuity book grew by \$887 million or 12.5% (FY13: 9.1%) (ex-High Yield Fund maturities), slightly exceeding the revised guidance range of 10%-12%. A higher target of 12%-14% has been set for FY15.

“Modern lifetime annuities are undeniably the most popular retirement product to be launched in the last decade in Australia”, said Mr Benari.

“Retirees have voted with their wallets because they saw that annuities didn’t miss a beat during the GFC. They want to complement the market exposure of account-based pensions with the security and reliability of guaranteed lifetime income. There’s a clear trend to holding both investments in their portfolio, each serving a distinct purpose”.

Challenger Life had \$11.1 billion under management as at 30 June 2014. Average AUM over the year was \$10.8 billion, up 6% and against which a stable average margin of 4.5% delivered Life cash operating earnings (COE) of \$481 million, an increase of 6%.

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

Funds Management’s net flows were \$2.1 billion and its average FUM rose 24% to \$44.4 billion, resulting in EBIT growth of 27% to \$43 million and delivering a pre-tax ROE of 32.8%, up from 26.4% a year earlier.

“Our Funds Management division more than doubled its earnings over the last two years, and with \$50 billion in unfilled investment capacity, we’re now one step closer to our ultimate ambition of becoming a top 5 Australian fund manager”, said Mr Benari.

Challenger’s Fidante Partners division added five new investment managers over the past year; Whitehelm Capital (global infrastructure); WyeTree Asset Management (global fixed income); River and Mercantile (UK and global equities); Tempo Asset Management (global equities, smart beta) and Arete Investment Partners (Australian equities).

“With our boutique fund business we’ve hit the right model of institutional back-office and distribution support with front-office autonomy, incentive and reward”, said Mr Benari.

Whitehelm Capital was formed by merging CIP’s infrastructure business with Access Capital Advisers. This \$4 billion boutique gives critical mass to Challenger’s infrastructure investing capabilities, while allowing CIP to focus on winning and filling co-investment mandates in the commercial property and fixed income sectors.

## Distribution, Product and Marketing (DPM)

Product innovation continues to lie at the heart of Challenger's revival of the Australian lifetime annuities market. FY14 saw the evolution of the Liquid Lifetime annuity to permit even closer tailoring to individual customer needs, while the Care Annuity was enhanced to accommodate aged care funding reforms which commenced in July 2014. These changes are expected to significantly increase Care's addressable market.

While Challenger is an independent investment manager, annuities are an advised product, so the provision of exceptional support and service to third-party financial advisers remains a top priority for the company. In FY14 Challenger once again ranked first for BDM support and second for technical services in a Wealth Insights benchmark survey against leading fund managers.

Challenger continues to strengthen its reputation among financial advisers as a leader in retirement incomes, with the latest independent 2014 brand benchmark survey reporting that 89% of advisers continue to hold this view.

The company's new "Retirement on Paper" consumer advertising campaign was successfully launched in September 2013 and is creating pull-through demand for annuities, with 45% of financial advisers reporting recent reverse enquiry about annuities from their clients.

To help meet this demand, Challenger is developing technology to make annuities available on investment platforms.

The Bendzulla SMSF actuarial certificate business acquired during the year continues to perform to plan, with ongoing exploration of new pension-phase services to offer its SMSF accountant customer base.

## Capital

As at 30 June 2014, Challenger held \$1.044 billion more capital and cash than the Australian Prudential Regulation Authority's (APRA's) regulatory minimum. This regulatory minimum is designed to ensure that a 1:200 year adverse financial event will not impact Challenger Life, which at balance date held 1.7 times this amount, including the LAGIC transition balance.

Post-balance date, the company will raise \$250 million in an underwritten ordinary share placement, scheduled for completion via a book build. Challenger has requested that the Australian Securities Exchange place its shares into a trading halt for one day while this process takes place. An accompanying Share Purchase Plan is expected to raise \$30 million from Australian and New Zealand retail investors. The majority of proceeds from the placement and SPP will be invested into Challenger Life as Common Equity Tier 1 capital. Challenger also intends to raise \$250 million via Challenger Capital Notes<sup>^</sup> with the proceeds used to fund Additional Tier 1 capital for Challenger Life.

Following the capital initiatives, Challenger Life's PCA ratio will increase to 2.1 times<sup>^^</sup> on a 30 June 2014 pro-forma basis, including the LAGIC transition amount.

## Outlook

"Challenger is growing in lock step with the maturation of the Australian super system, as it evolves from a supplementary savings scheme to a fully self-funded private pension provider", said Mr Benari.

"This financial year we expect retail annuity book growth of 12%-14% and Life cash earnings in the range of \$535-545 million<sup>^^</sup>. While funds management's earnings aren't as predictable, we believe we have the products and performance to realise our ambition of becoming a top 5 Australian fund manager".

## Overview

Key metrics	FY14	FY13	Movement
Normalised NPAT (\$m)	329	308	7%
Statutory NPAT (\$m)	341	417	(18%)
Normalised EBIT (\$m)	388	365	6%
Normalised EPS	64.0	58.6	9%
Statutory EPS	66.3	79.2	(17%)
Normalised ROE - post tax (%)	16.1	16.8	(70 bps)
Statutory ROE - post tax (%)	16.7	22.7	(600 bps)
Dividend (cps)	26.0	20.0	30%

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\* 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 21 in the Director's Report and Note 2 - segment information in the Challenger Limited 30 June 2014 financial report. The Normalised Profit is not audited but has been subject to a review performed by Ernst & Young.

^ Challenger Capital Notes are subordinated, unsecured convertible notes to be issued by Challenger Limited in Australia. Challenger may raise more or less than \$250 million. The proposed Capital Notes issue will not be underwritten.

^^Assumes completion of \$250 million ordinary equity, \$30 million raised via the SPP and \$250 million from Challenger Capital Notes.

The forward-looking statements, estimates and projections contained in this release are not representations as to future performance and nothing in this release should be relied upon as guarantees or representations of future performance.

This announcement does not constitute an offer to sell, or a solicitation of an offer to buy, any securities in the United States or in any other country. The new securities to be offered and sold in the institutional placement, the SPP and the Challenger Capital Notes offering have not been, and will not be, registered under the US Securities Act of 1933 (the "US Securities Act") or the securities laws of any state or other jurisdiction of the United States and, accordingly, may not be offered or sold, directly or indirectly, in the United States unless they have been registered under the U.S. Securities Act or are offered and sold in a transaction exempt from, or not subject to, the registration requirements of the U.S. Securities Act and any other applicable U.S. state securities laws.